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Transcript Exhibit(s)

Docket #(s): W-08500A-10-0382

Exhibit #: S7-S15, RUCO1

Arizona Corporation Commission

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To: Docket Control

Date: November 17, 2011

Re: Goodman Water Company / Rates
W-02500A-10-0382
Volumes I through V, Concluded
July 26 through November 1, 2011

STATUS OF ORIGINAL EXHIBITS

EXHIBITS FILED WITH DOCKET CONTROL

Goodman Water Company (A Exhibits)

1 through 23

James Schoemperlen (JS Exhibits)

8, 9, 21, 41 through 44, 51, 52

Lawrence Wawrzyniak (LW Exhibits)

1 through 6, 8, 9

Staff (S Exhibits)

1 through 4, 7 through 15

Residential Utility Consumer Office (RUCO Exhibits)

1 through 3, 5 through 14

EXHIBITS RETURNED TO PARTIES

James Schoemperlen (JS Exhibits)

1-2	Not utilized
3-4	Not offered [by design or oversight]
4a	Not utilized
4b	Not offered [by design or oversight]
5	Not offered [by design or oversight]
5a	Not utilized
6	Not utilized
7	Not offered [by design or oversight]
10	Not offered [by design or oversight]
12-14	Not offered [by design or oversight]
15	Not utilized
16	Not offered [by design or oversight]
17	Not utilized
20	Not utilized
20b	Not utilized
22-23	Not utilized
25-38	Not utilized
38a	Not utilized
39a-c	Not utilized
40	Not utilized
46a	Not offered [by design or oversight]

Lawrence Wawrzyniak (LW Exhibits)

7 Not utilized

Residential Utility Consumer Office (RUCO Exhibits)

4 Withdrawn

EXHIBITS TO BE PROVIDED

Staff (S Exhibits)

- 5 Marlin Scott's Calculation of the 1,800 customers; to be provided by Staff (see page 600 of transcript)
- 6 Third step of Marlin Scott's calculation from MSJ-1; to be provided by Staff (see page 600 of transcript)

EXHIBITS NOT UTILIZED
Not given to court reporter

James Schoemperlen (JS Exhibits)

11, 18, 19, 20a, 24, 45, 47-50

Copy to:

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Mr. Daniel Pozefsky, RUCO
Mr. Lawrence Wawrzyniak, Intervenor
Mr. James Schoemperlen, Intervenor

BEFORE THE ARIZONA CORPORATION COMMISSION

GARY PIERCE
Chairman
BOB STUMP
Commissioner
SANDRA D. KENNEDY
Commissioner
PAUL NEWMAN
Commissioner
BRENDA BURNS
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. W-02500A-10-0382
GOODMAN WATER COMPANY, AN)
ARIZONA CORPORATION, FOR (i) A)
DETERMINATION OF THE FAIR VALUE)
OF ITS UTILITY PLANT AND PROPERTY)
AND (ii) AN INCREASE IN ITS WATER RATES)
AND CHARGES FOR UTILITY SERVICE)
BASED THEREON.)

DIRECT

TESTIMONY

OF

JUAN C. MANRIQUE

PUBLIC UTILITIES ANALYST I

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MARCH 21, 2011

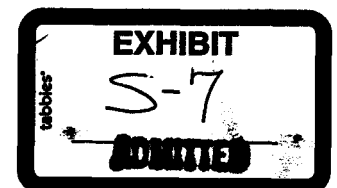


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**EXECUTIVE SUMMARY
GOODMAN WATER COMPANY
DOCKET NO. W-02500A-10-0382**

The direct testimony of Staff witness Juan C. Manrique addresses the following issues:

Capital Structure – Staff recommends that the Commission adopt a capital structure for Goodman Water Company (“Applicant”) for this proceeding consisting of 18.6 percent debt and 81.4 percent equity which is the Applicant’s actual capital structure.

Cost of Equity – Staff recommends that the Commission adopt a 9.1 percent return on equity (“ROE”) for the Applicant. Staff’s estimated ROE for the Applicant is based on cost of equity estimates for the sample companies ranging from 9.0 percent for the discounted cash flow method (“DCF”) to 9.1 percent for the capital asset pricing model (“CAPM”).

Cost of Debt – Staff recommends that the Commission adopt an 8.5 percent cost of debt.

Overall Rate of Return – Staff recommends that the Commission adopt a 9.0 percent overall rate of return (“ROR”).

Mr. Bourassa’s Testimony – The Commission should reject the Applicant-proposed 11.0 percent ROE for the following reasons:

Mr. Bourassa’s DCF estimates rely heavily on analysts’ forecasts and provide little weight to historical dividend per share growth rates. Also, Mr. Bourassa’s CAPM estimates rely solely on future estimates of a risk-free rate which unnecessarily biases his estimates upward.

I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Juan C. Manrique. I am a Public Utilities Analyst employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utilities Analyst.

A. In my position as a Public Utilities Analyst, I perform studies to estimate the cost of capital component in rate filings to determine the overall revenue requirement and analyze requests for financing authorizations.

Q. Please describe your educational background and professional experience.

A. I graduated from Arizona State University and received a Bachelor of Science degree in Finance. My course of studies included courses in corporate and international finance, investments, accounting, statistics, and economics. I began employment as a Staff Public Utilities Analyst in October 2008. My professional experience includes two years as a Loan Officer with a homebuilder and as an Associate for an Investor Relations firm.

Q. What is the scope of your testimony in this case?

A. My testimony provides Staff's recommended capital structure, cost of debt, return on equity ("ROE") and overall rate of return ("ROR") for establishing the revenue requirements for Goodman Water Company's ("GWC" or "Applicant") pending rate application.

1 **Q. Please provide a brief description of GWC.**

2 A. GWC is a for-profit Arizona corporation that is engaged in the business of providing
3 public water (approximately 620 customers) utility service in a portion of Tucson within
4 Pinal County, Arizona.
5

6 **Summary of Testimony and Recommendations**

7 **Q. Briefly summarize how Staff's cost of capital testimony is organized.**

8 A. Staff's cost of capital testimony is presented in eleven sections. Section I is this
9 introduction. Section II discusses the concept of weighted average cost of capital
10 ("WACC"). Section III presents the concept of capital structure and presents Staff's
11 recommended capital structure for GWC in this proceeding. Section IV discusses the
12 concepts of ROE and risk. Section V presents the methods employed by Staff to estimate
13 GWC's ROE. Section VI presents the findings of Staff's ROE analysis. Section VII
14 presents Staff's final cost of equity estimates for GWC. Section VIII presents Staff's Cost
15 of Debt recommendation. Section IX presents Staff's ROR recommendation. Section X
16 presents Staff's comments on the direct testimony of the Applicant's witness, Mr. Thomas
17 J. Bourassa. Finally, section XI presents the conclusions.
18

19 **Q. Have you prepared any exhibits to accompany your testimony?**

20 A. Yes. I prepared nine schedules (JCM-1 to JCM-9) that support Staff's cost of capital
21 analysis.
22

23 **Q. What is Staff's recommended rate of return for GWC?**

24 A. Staff recommends a 9.0 percent overall ROR, as shown in Schedule JCM-1. Staff's ROR
25 recommendation is based on cost of equity estimates for GWC that range from 9.0 percent

1 using the discounted cash flow method ("DCF") to 9.1 percent using the capital asset
2 pricing model ("CAPM") and a cost of debt of 8.5 percent.

3
4 **GWC's Proposed Overall Rate of Return**

5 **Q. Briefly summarize GWC's proposed capital structure, cost of debt, return on equity**
6 **and overall rate of return for this proceeding.**

7 A. Table 1 summarizes the Applicant's proposed capital structure, cost of debt, return on
8 equity and overall rate of return in this proceeding:

9
10 **Table 1**

	Weight	Cost	Weighted Cost
Long-term Debt	18.3%	8.5%	1.6%
Common Equity	81.7%	11.0%	<u>9.0%</u>
Cost of Capital/ROR			10.5%

11
12 GWC is proposing an overall rate of return of 10.5 percent.

13
14 **II. THE WEIGHTED AVERAGE COST OF CAPITAL**

15 **Q. Briefly explain the cost of capital concept.**

16 A. The cost of capital is the opportunity cost of choosing one investment over others with
17 equivalent risk. In other words, the cost of capital is the return that stakeholders expect
18 for investing their financial resources in a determined business venture over another
19 business venture.

20
21 **Q. What is the overall cost of capital?**

22 A. The cost of capital to a company issuing a variety of securities (i.e., stock and
23 indebtedness) is an average of the cost rates on all issued securities adjusted to reflect the

relative amounts for each security in the company's entire capital structure. Thus, the overall cost of capital is the weighted average cost of capital ("WACC").

Q. How is the WACC calculated?

A. The WACC is calculated by adding the weighted expected returns of a firm's securities. The WACC formula is:

Equation 1.

$$WACC = \sum_{i=1}^n W_i * r_i$$

In this equation, W_i is the weight given to the i^{th} security (the proportion of the i^{th} security relative to the portfolio) and r_i is the expected return on the i^{th} security.

Q. Can you provide an example demonstrating application of Equation 1?

A. Yes. For this example, assume that an entity has a capital structure composed of 60 percent debt and 40 percent equity. Also, assume that the embedded cost of debt is 6.0 percent and the expected return on equity, i.e. the cost of equity, is 10.5 percent.

Calculation of the WACC is as follows:

$$WACC = (60\% * 6.0\%) + (40\% * 10.5\%)$$

$$WACC = 3.60\% + 4.20\%$$

$$WACC = 7.80\%$$

The weighted average cost of capital in this example is 7.80 percent. The entity in this example would need to earn an overall rate of return of 7.80 percent to cover its cost of capital.

III. CAPITAL STRUCTURE

Background

Q. Please explain the capital structure concept.

A. The capital structure of a firm is the relative proportions of each type of security--short-term debt, long-term debt (including capital leases), preferred stock and common stock--that are used to finance the firm's assets.

Q. How is the capital structure expressed?

A. The capital structure of a company is expressed as the percentage of each component of the capital structure (capital leases, short-term debt, long-term debt, preferred stock and common stock) relative to the entire capital structure.

As an example, the capital structure for an entity that is financed by \$20,000 of capital leases, \$85,000 of long-term debt, \$15,000 of preferred stock and \$80,000 of common stock is shown in Table 2.

Table 2

Component			%
Capital Leases	\$20,000	(\$20,000/\$200,000)	10.0%
Long-Term Debt	\$85,000	(\$85,000/\$200,000)	42.5%
Preferred Stock	\$15,000	(\$15,000/\$200,000)	7.5%
Common Stock	\$80,000	(\$80,000/\$200,000)	40.0%
Total	\$200,000		100%

1 The capital structure in this example is composed of 0.0 percent short-term debt, 10.0
2 percent capital leases, 42.5 percent long-term debt, 7.5 percent preferred stock and 40.0
3 percent common stock.

4
5 **GWC's Capital Structure**

6 **Q. What capital structure does GWC propose?**

7 A. The Applicant proposes a capital structure composed of 18.3 percent debt and 81.7 percent
8 common equity.

9
10 **Q. How does GWC's proposed capital structure compare to capital structures of the**
11 **publicly-traded water utilities?**

12 A. GWC's updated capital structure is composed of 18.3 percent debt and 81.7 percent
13 equity. Schedule JCM-4 shows the capital structures of six publicly-traded water
14 companies ("sample water companies") as of September 2010. The average capital
15 structure for the sample water utilities is comprised of approximately 52.6 percent debt
16 and 47.4 percent equity.

17
18 **Staff's Capital Structure**

19 **Q. What is Staff's recommended capital structure for GWC?**

20 A. Staff recommends using the Applicant's current capital structure which is composed of
21 18.6 percent debt and 81.4 percent equity.

22
23 **Q. Why does Staff's capital structure differ from the Applicant's proposed capital**
24 **structure?**

25 A. Staff used the most updated capital structure, as of December 31, 2010, provided by the
26 Applicant in response to Staff Data Request 5.1, rather than the end of the test year.

1 **IV. RETURN ON EQUITY**

2 **Background**

3 **Q. Please define the term “cost of equity capital.”**

4 A. The cost of equity is the rate of return that investors expect to earn on their investment in a
5 business entity given its risk. In other words, the cost of equity to the entity is the
6 investors’ expected rate of return on other investments of similar risk. As investors have a
7 wide selection of stocks to choose from, they will choose stocks with similar risks but
8 higher returns. Therefore, the market determines the entity’s cost of equity.

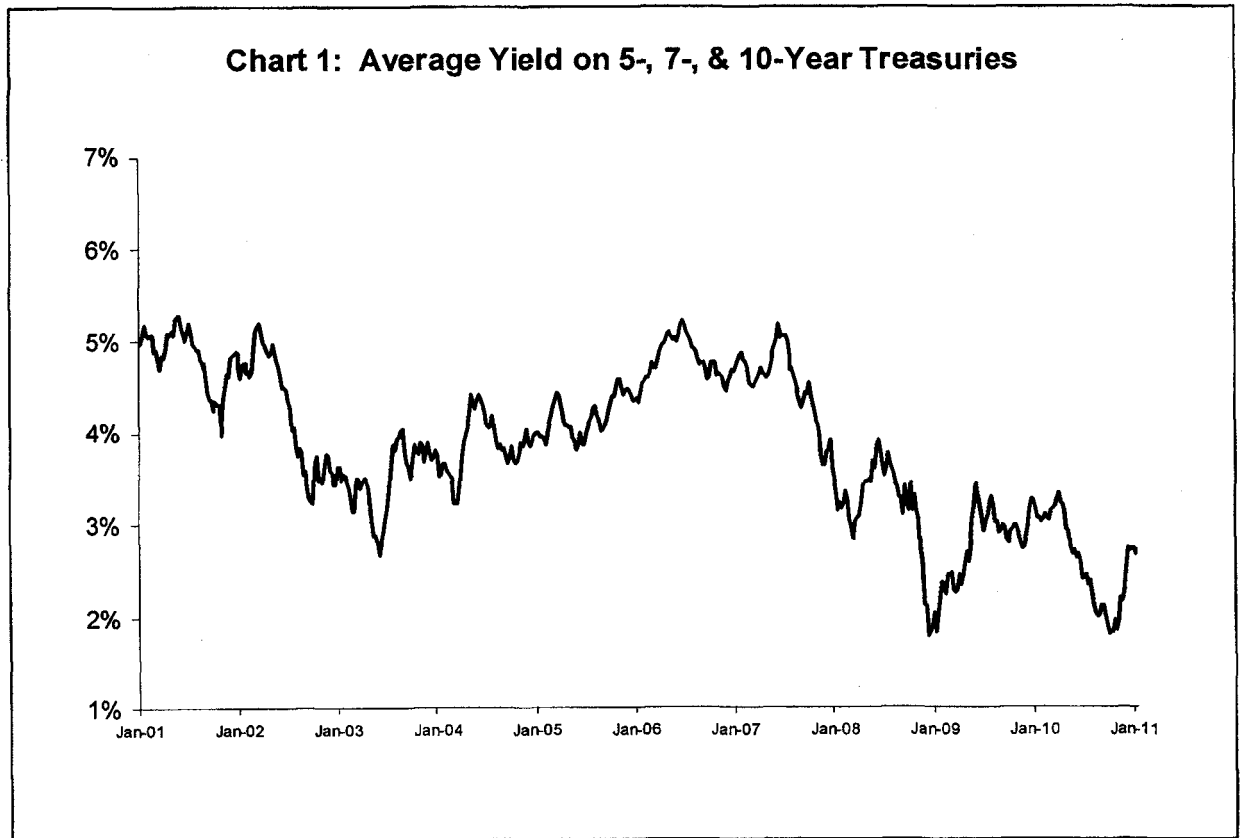
9
10 **Q. Is there a correlation between interest rates and the cost of equity?**

11 A. Yes. The cost of equity tends to move in the same direction as interest rates. This
12 relationship is part of the CAPM formula. The CAPM is a market-based model employed
13 by Staff for estimating the cost of equity. The CAPM is further discussed in Section V of
14 this testimony.

15
16 **Q. What has been the general trend of interest rates in recent years?**

17 A. A chronological chart of interest rates is a good tool to show interest rate history and
18 identify trends. Chart 1 graphs intermediate U.S. treasury rates from January 2001 to
19 January 2011.

20

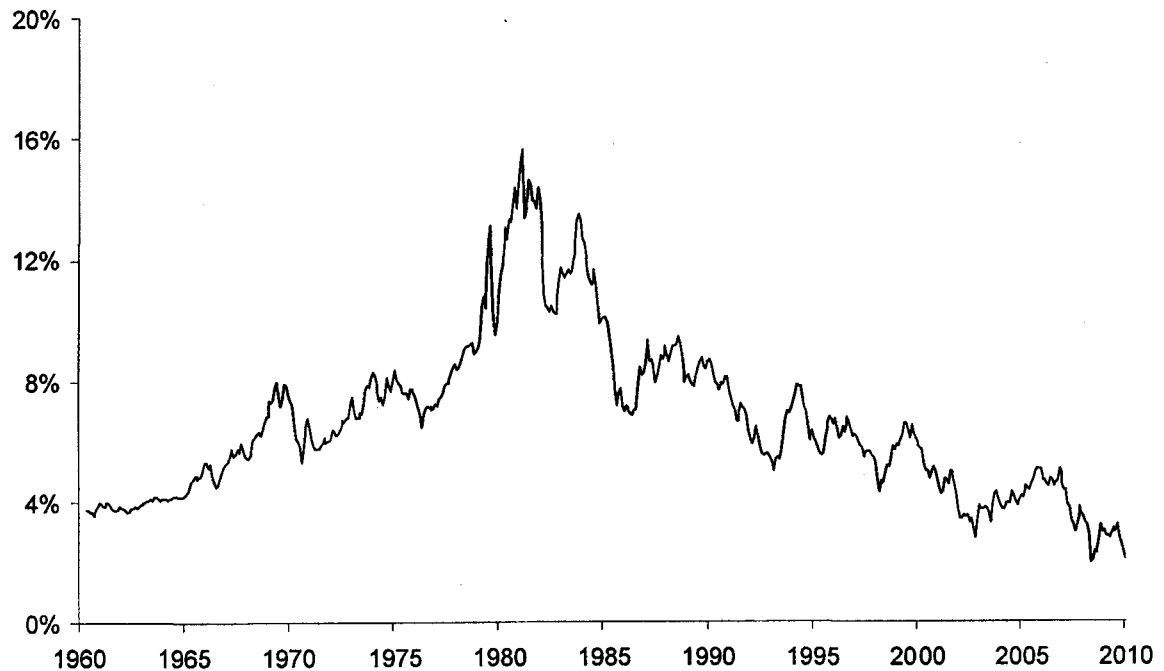


15 Chart 1 shows that intermediate interest rates trended downward from 2000 to mid-2003,
16 then turned slightly upward until mid-2007 and have trended downward since with dips in
17 early-2009 and again in early-2010.

18
19 **Q. What has been the general trend in interest rates longer term?**

20 **A.** U.S. Treasury rates from 1959 to present are shown in Chart 2. The chart shows that
21 interest rates trended upward through the mid-1980s and have trended downward over the
22 last 25 years.

Chart 2: History of 5- and 10-Year Treasury Yields



Source: Federal Reserve

Q. Do these trends suggest anything in terms of cost of equity?

A. Yes. As previously discussed, interest rates and cost of equity tend to move in the same direction. The implication is that the cost of equity has declined in the past 25 years.

Q. Do actual returns represent the cost of equity?

A. No. The cost of equity represents investors' *expected* returns and not realized returns.

1 **Q. Is there any information available that leads to an understanding of the relationship**
2 **between the equity returns required for a regulated water utility and those required**
3 **in the market as a whole?**

4 A. Yes. A comparison of betas, a component of the CAPM discussed in Section V, for the
5 water utility industry and the market provide insight into this relationship. The average
6 beta (0.77)¹ for a water utility is lower than the theoretical average beta for all stocks (1.0).
7 According to the CAPM formula, the cost of equity capital moves in the same direction as
8 beta. Since the beta for the water utility industry is lower than the beta for the market, the
9 implication is that the required return on equity for a regulated water utility is below the
10 average required return on the market.

11
12 **Risk**

13 **Q. Please define risk in relation to cost of capital.**

14 A. Risk, as it relates to an investment, is the variability or uncertainty of the returns on a
15 particular security. Investors are risk averse and require a greater potential return to invest
16 in relatively greater risk opportunities, i.e., investors require compensation for taking
17 on additional risk. Risk is generally separated into two components. Those components
18 are market risk (systematic risk) and non-market risk (diversifiable risk or firm-specific
19 risk).

20
21 **Q. What is market risk?**

22 A. Market risk or systematic risk is the risk of an investment that cannot be reduced through
23 diversification. Market risk stems from factors that affect all securities such as recessions,
24 war, inflation and high interest rates. Since these factors affect the entire market they
25 cannot be eliminated through diversification. Market risk does not impact each security to

¹ See Schedule JCM-7

1 the same degree. The degree to which any security's returns is affected by the market can
2 be measured using Beta. Beta reflects the business risk and the financial risk of a security.

3
4 **Q. Please define business risk.**

5 A. Business risk is the fluctuation of earnings inherent in a firm's operations and environment
6 such as competition and adverse economic conditions that may impair its ability to
7 provide returns on investment. Companies in the same or similar line of business tend to
8 experience the same fluctuations in business cycles.

9
10 **Q. Please define financial risk.**

11 A. Financial risk is the fluctuation of earnings inherent in using debt financing by a firm that
12 may impair its ability to provide adequate return. The more a company uses debt
13 financing, the more the company becomes exposed to financial risk.

14
15 **Q. Do business risk and financial risk affect the cost of equity?**

16 A. Yes.

17
18 **Q. Is a firm subject to any other risk?**

19 A. Yes. Firms are also subject to unsystematic or firm-specific risk. Examples of
20 unsystematic risk include losses caused by labor problems, nationalization of assets, loss
21 of a big client or weather conditions. Investors can eliminate firm-specific risk by holding
22 a diverse portfolio; thus, it is not of concern to diversified investors.

1 **Q. How does GWC's financial risk compare to the sample water companies' financial**
2 **risk from the perspective of an investor?**

3 A. From an investor's perspective GWC's capital structure is less risky than the sample water
4 companies. Schedule JCM-4 shows the capital structures of the six publicly-traded water
5 companies ("sample water companies") as of September 2010, as well as GWC's actual
6 capital structure. As of September 2010, the sample water utilities were capitalized with
7 approximately 52.6 percent debt and 47.4 percent equity, while GWC's actual capital
8 structure consists of approximately 18.6 percent debt and 81.4 percent equity. Thus,
9 GWC's shareholders bear less financial risk than the shareholders of the sample
10 companies.

11
12 **Q. Is firm-specific risk measured by beta?**

13 A. No. Firm-specific risk is not measured by beta.

14
15 **Q. Is the cost of equity affected by firm-specific risk?**

16 A. No. Since firm-specific risk can be eliminated through diversification, it does not affect
17 the cost of equity.

18
19 **Q. Can investors expect additional returns for firm-specific risk?**

20 A. No. Investors who hold diversified portfolios can eliminate firm-specific risk and,
21 consequently, do not require any additional return. Since investors who choose to be less
22 than fully-diversified must compete in the market with fully-diversified investors, the
23 former cannot expect to be compensated for unique risk.

24

V. ESTIMATING THE COST OF EQUITY

Introduction

Q. Did Staff directly estimate the cost of equity for GWC?

A. No. Since GWC is not a publicly-traded company, Staff is unable to directly estimate the Applicant's cost of equity due to the unavailability of financial information. Instead, Staff uses an average of a representative sample group to reduce the sample error resulting from random fluctuations in the market at the time the information is gathered.

Q. What companies did Staff select as proxies or comparables for GWC?

A. Staff's sample consists of the following six publicly-traded water utilities: American States Water, California Water, Aqua America, Connecticut Water Services, Middlesex Water and SJW Corp. Staff chose these companies because they are publicly-traded and receive the majority of their earnings from regulated operations.

Q. What models did Staff implement to estimate GWC's cost of equity?

A. Staff used two market-based models to estimate the cost of equity for GWC: the DCF and the CAPM.

Q. Please explain why Staff chose the DCF and CAPM models.

A. Staff chose to use the DCF and CAPM models because they are widely-recognized market-based models and have been used extensively to estimate the cost of equity. An explanation of the DCF and CAPM models follows.

1 **Discounted Cash Flow Model Analysis**

2 **Q. Please provide a brief summary of the theory upon which the DCF method of**
3 **estimating the cost of equity is based.**

4 A. The DCF method of stock valuation is based on the theory that the value of an investment
5 is equal to the sum of the future cash flows generated from the aforementioned investment
6 discounted to the present time. This method uses expected dividends, market price and
7 dividend growth rate to calculate the cost of capital. Professor Myron Gordon pioneered
8 the DCF method in the 1960s. The DCF method has become widely used to estimate the
9 cost of equity for public utilities due to its theoretical merit and its simplicity. Staff used
10 the financial information for the relevant six sample companies in the DCF model and
11 averaged the results to determine an estimated cost of equity for the sample companies.
12

13 **Q. Does Staff use more than one version of the DCF Model?**

14 A. Yes. Staff uses two versions of the DCF model: the constant-growth DCF Model and the
15 multi-stage or non-constant growth DCF. The constant-growth DCF Model assumes that
16 an entity's dividends will grow indefinitely at the same rate. The multi-stage growth DCF
17 model assumes the dividend growth rate will change at some point in the future.

1 *The Constant-Growth DCF*

2 **Q. What is the mathematical formula used in Staff's constant-growth DCF analysis?**

3 A. The constant-growth DCF formula used in Staff's analysis is:

Equation 2 :

$$K = \frac{D_1}{P_0} + g$$

where : K = the cost of equity
 D_1 = the expected annual dividend
 P_0 = the current stock price
 g = the expected infinite annual growth rate of dividends

4 Equation 2 assumes that the entity has a constant earnings retention rate and that its
5 earnings are expected to grow at a constant rate. According to Equation 2, a stock with a
6 current market price of \$10 per share, an expected annual dividend of \$0.45 per share and
7 an expected dividend growth rate of 3.0 percent per year has a cost of equity to the entity
8 of 7.5 percent reflected by the sum of the dividend yield ($\$0.45 / \$10 = 4.5$ percent) and the
9 3.0 percent annual dividend growth rate.

10

11 **Q. How did Staff calculate the dividend yield component (D_1/P_0) of the constant-growth**
12 **DCF formula?**

13 A. Staff calculated the yield component of the DCF formula by dividing the expected annual
14 dividend² (D_1) by the spot stock price (P_0) after the close of the market January 19, 2011,
15 as reported by the website *MSN Money*.

² Value Line Summary & Index. 1-28-11

1 **Q. Why did Staff use the January 19, 2011, spot price rather than a historical average**
2 **stock price to calculate the dividend yield component of the DCF formula?**

3 A. Current, rather than historic, market stock price is used in order to be consistent with
4 finance theory, i.e., the efficient market hypothesis. The efficient market hypothesis
5 asserts that the current stock price reflects all available information on a stock including
6 investors' expectations of future returns. Use of a historical average of stock prices
7 illogically discounts the most recent information in favor of less recent information. The
8 latter is stale and is representative of underlying conditions that may have changed.

9
10 **Q. How did Staff estimate the dividend growth (g) component of the constant-growth**
11 **DCF model represented by Equation 2?**

12 A. The dividend growth component used by Staff is determined by the average of six
13 different estimation methods, as shown in Schedule JCM-8. Staff calculated historical and
14 projected growth estimates on dividend-per-share ("DPS"),³ earnings-per-share ("EPS")⁴
15 and sustainable growth bases.

16
17 **Q. Why did Staff examine EPS growth to estimate the dividend growth component of**
18 **the constant-growth DCF model?**

19 A. Historic and projected EPS growth are used because dividends are related to earnings.
20 Dividend distributions may exceed earnings in the short run but cannot continue
21 indefinitely. In the long term, dividend distributions are dependent on earnings.

³ Derived from information provided by *Value Line*

⁴ Derived from information provided by *Value Line*

1 **Q. How did Staff estimate historical DPS growth?**

2 A. Staff estimated historical DPS growth by calculating the average rate of growth in DPS of
3 the sample water companies from 2000 to 2010. The results of that calculation are shown
4 in Schedule JCM-5. Staff calculated an average historical DPS growth rate of 3.1 percent
5 for the sample water utilities for the aforementioned period.

6

7 **Q. How did Staff estimate the projected DPS growth?**

8 A. Staff calculated an average of the projected DPS growth rates for the sample water utilities
9 from *Value Line*. The average projected DPS growth rate is 3.1 percent, as shown in
10 Schedule JCM-5.

11

12 **Q. How did Staff calculate the historical EPS growth rate?**

13 A. Staff estimated historical EPS growth by calculating the average rate of growth in EPS of
14 the sample water companies from 2000 to 2010. Staff calculated an average historical
15 EPS growth rate of 4.6 percent for the sample water utilities for the aforementioned
16 period, as shown in Schedule JCM-5.

17

18 **Q. How did Staff estimate the projected EPS growth?**

19 A. Staff calculated an average of the projected EPS growth rates for the sample water utilities
20 from *Value Line*. The average projected EPS growth rate is 4.9 percent, as shown in
21 Schedule JCM-5.

22

1 **Q. How does Staff calculate its historical and projected sustainable growth rates?**

2 A. Historical and projected sustainable growth rates are calculated by adding their respective
3 retention growth rate terms (br) to their respective stock financing growth rate terms (vs)
4 as shown in Schedule JCM-6.

5
6 **Q. What is retention growth?**

7 A. Retention growth is the growth in dividends due to the retention of earnings. The
8 retention growth concept is based on the theory that dividend growth cannot be achieved
9 unless the company retains and reinvests some of its earnings. The retention growth is
10 used in Staff's calculation of sustainable growth shown in Schedule JCM-6.

11
12 **Q. What is the formula for the retention growth rate?**

13 A. The retention growth rate is the product of the retention ratio and the book/accounting
14 return on equity. The retention growth rate formula is:

15 Equation 3 :

$$\text{Retention Growth Rate} = br$$

 where : b = the retention ratio (1 – dividend payout ratio)
 r = the accounting/book return on common equity

16
17 **Q. How did Staff calculate the average historical retention growth rate (br) for the**
18 **sample water utilities?**

19 A. Staff calculated the historical retention rates by averaging the retention rates for the
20 sample water companies from 2001 to 2010. The historical average retention (br) growth
21 for the sample water utilities is 2.9 percent, as shown in Schedule JCM-6.

1 **Q. How did Staff determine projected retention growth rate (br) for the sample water**
2 **utilities?**

3 A. Staff used the retention growth projections for the sample water utilities for the period
4 2013 to 2015 from *Value Line*. The projected average retention growth rate for the sample
5 water utilities is 5.6 percent, as shown in Schedule JCM-6.

6
7 **Q. When can retention growth provide a reasonable estimate of future dividend**
8 **growth?**

9 A. The retention growth rate is a reasonable estimate of future dividend growth when the
10 retention ratio is reasonably constant and the entity's market price to book value ("market-
11 to-book ratio") is expected to be 1.0. The average retention ratio has been reasonably
12 constant in recent years. However, the market-to-book ratio for the sample water utilities
13 is 2.0, notably higher than 1.0, as shown in Schedule JCM-7.

14
15 **Q. Is there any financial implication of a market-to-book ratio greater than 1.0?**

16 A. Yes. A market-to-book ratio greater than 1.0 implies that investors expect an entity to
17 earn an accounting/book return on its equity that exceeds its cost of equity. The
18 relationship between required returns and expected cash flows is readily observed in the
19 fixed securities market. For example, assume an entity contemplating issuance of bonds
20 with a face value of \$10 million at either 6 percent or 8 percent, and thus, paying annual
21 interest of \$600,000 or \$800,000, respectively. Regardless of investors' required return on
22 similar bonds, investors will be willing to pay more for the bonds if issued at 8 percent
23 than if the bonds are issued at 6 percent. For example, if the current interest rate required
24 by investors is 6 percent, then they would bid \$10 million for the 6 percent bonds and
25 more than \$10 million for the 8 percent bonds. Similarly, if equity investors require a 9
26 percent return and expect an entity to earn accounting/book returns of 13 percent, the

1 market will bid up the price of the entity's stock to provide the required return of 9
2 percent.

3
4 **Q. How has Staff generally recognized a market-to-book ratio exceeding 1.0 in its cost of**
5 **equity analyses in recent years?**

6 A. Staff has assumed that investors expect the market-to-book ratio to remain greater than
7 1.0. Given that assumption, Staff has added a stock financing growth rate (vs) term to the
8 retention ratio (br) term to calculate its historical and projected sustainable growth rates.

9
10 **Q. Do the historical and projected sustainable growth rates Staff uses to develop its**
11 **DCF cost of equity in this case continue to include a stock financing growth rate**
12 **term?**

13 A. Yes.

14
15 **Q. What is stock financing growth?**

16 A. Stock financing growth is the growth in an entity's dividends due to the sale of stock by
17 that entity. Stock financing growth is a concept derived by Myron Gordon and discussed
18 in his book *The Cost of Capital to a Public Utility*.⁵ Stock financing growth is the product
19 of the fraction of the funds raised from the sale of stock that accrues to existing
20 shareholders (v) and the fraction resulting from dividing the funds raised from the sale of
21 stock by the existing common equity (s).

⁵ Gordon, Myron J. *The Cost of Capital to a Public Utility*. MSU Public Utilities Studies, Michigan, 1974. pp 31-35.

1 **Q. What is the mathematical formula for the stock financing growth rate?**

2 A. The mathematical formula for stock financing growth is:

Equation 4:

$$\text{Stock Financing Growth} = vs$$

where: v = Fraction of the funds raised from the sale of stock that accrues
to existing shareholders

s = Funds raised from the sale of stock as a fraction of the existing
common equity

3
4 **Q. How is the variable v presented above calculated?**

5 A. Variable v is calculated as follows:

Equation 5:

$$v = 1 - \left(\frac{\text{book value}}{\text{market value}} \right)$$

6
7 For example, assume that a share of stock has a \$30 book value and is selling for \$45.
8 Then, to find the value of v , the formula is applied:

$$v = 1 - \left(\frac{30}{45} \right)$$

9 In this example, v is equal to 0.33.

10
11 **Q. How is the variable s presented above calculated?**

12 A. Variable s is calculated as follows:

13 Equation 6:

14
$$s = \frac{\text{Funds raised from the issuance of stock}}{\text{Total existing common equity before the issuance}}$$

15

1 For example, assume that an entity has \$150 in existing equity, and it sells \$30 of stock.
2 Then, to find the value of s , the formula is applied:

$$s = \left(\frac{30}{150} \right)$$

3 In this example, s is equal to 20.0 percent.
4

5 **Q. What is the vs term when the market-to-book ratio is equal to 1.0?**

6 A. A market-to-book ratio equal to 1.0 reflects that investors expect an entity to earn a
7 book/accounting return on their equity investment equal to the cost of equity. When the
8 market-to-book ratio is equal to 1.0, none of the funds raised from the sale of stock by the
9 entity accrues to the benefit of existing shareholders, i.e., the term v is equal to zero (0.0).
10 Consequently, the vs term is also equal to zero (0.0). When stock financing growth is
11 zero, dividend growth depends solely on the br term.
12

13 **Q. What is the effect of the vs term when the market-to-book ratio is greater than 1.0?**

14 A. A market-to-book ratio greater than 1.0 reflects that investors expect an entity to earn a
15 book/accounting return on their equity investment greater than the cost of equity.
16 Equation 5 shows that when the market-to-book ratio is greater than 1.0 the v term is also
17 greater than zero. The excess by which new shares are issued and sold over book value
18 per share of outstanding stock is a contribution that accrues to existing stockholders in the
19 form of a higher book value. The resulting higher book value leads to higher expected
20 earnings and dividends. Continued growth from the vs term is dependent upon the
21 continued issuance and sale of additional shares at a price that exceeds book value per
22 share.

1 **Q. What *vs* estimate did Staff calculate from its analysis of the sample water utilities?**

2 A. Staff estimated an average stock financing growth of 2.4 percent for the sample water
3 utilities, as shown in Schedule JCM-6.

4
5 **Q. What would occur if an entity had a market-to-book ratio greater than 1.0 as a result
6 of investors expecting earnings to exceed the cost of equity capital and the entity
7 subsequently experienced newly-authorized rates equal to its cost of equity capital?**

8 A. Market pressure on the entity's stock price to reflect the change in future expected cash
9 flows would cause the market-to-book ratio to move toward 1.0.

10
11 **Q. Is inclusion of the *vs* term necessary if the average market-to-book ratio of the
12 sample water utilities falls to 1.0 due to authorized ROEs equaling the cost of equity?**

13 A. No. As discussed above, when the market-to-book ratio is equal to 1.0, none of the funds
14 raised from the sale of stock by the entity accrues to the benefit of existing shareholders
15 because the *v* term equals to zero, and consequently, the *vs* term also equals zero. When
16 the market-to-book ratio equals 1.0, dividend growth depends solely on the *br* term.
17 Staff's inclusion of the *vs* term assumes that the market-to-book ratio continues to exceed
18 1.0 and that the water utilities will continue to issue and sell stock at prices above book
19 value with the effect of benefitting existing shareholders.

20
21 **Q. What are Staff's historical and projected sustainable growth rates?**

22 A. Staff's estimated historical sustainable growth rate is 5.4 percent based on an analysis of
23 earnings retention for the sample water companies. Staff's projected sustainable growth
24 rate is 9.1 percent based on retention growth projected by *Value Line*. Schedule JCM-6
25 presents Staff's estimates of the sustainable growth rate.

1 **Q. What is Staff's expected infinite annual growth rate in dividends?**

2 A. Staff's expected infinite annual growth rate in dividends is 5.0 percent which is the
3 average of historical and projected DPS, EPS, and sustainable growth estimates. Staff's
4 calculation of the expected infinite annual growth rate in dividends is shown in Schedule
5 JCM-8.

6
7 **Q. What is Staff's constant-growth DCF estimate for the sample utilities?**

8 A. Staff's constant-growth DCF estimate is 8.3 percent, as shown in Schedule JCM-3.

9
10 *The Multi-Stage DCF*

11 **Q. Why did Staff implement the multi-stage DCF model to estimate GWC's cost of**
12 **equity?**

13 A. Staff generally uses the multi-stage DCF model to consider the assumption that dividends
14 may not grow at a constant rate. The multi-stage DCF uses two stages of growth. The
15 first stage is four years followed by the second constant growth stage.

1 **Q. What is the mathematical formula for the multi-stage DCF?**

2 A. The multi-stage DCF formula is shown in the following equation:

Equation 7 :

$$P_0 = \sum_{t=1}^n \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K-g_n} \left[\frac{1}{(1+K)} \right]^n$$

Where : P_0 = current stock price

D_t = dividends expected during stage 1

K = cost of equity

n = years of non – constant growth

D_n = dividend expected in year n

g_n = constant rate of growth expected after year n

3

4 **Q. What steps did Staff take to implement its multi-stage DCF cost of equity model?**

5 A. First, Staff projected future dividends for each of the sample water utilities using near-
6 term and long-term growth rates. Second, Staff calculated the rate (cost of equity) which
7 equates the present value of the forecasted dividends to the current stock price for each of
8 the sample water utilities. Lastly, Staff calculated an average of the individual sample
9 company cost of equity estimates.

10

11 **Q. How did Staff calculate near-term (stage-1) growth?**

12 A. The stage-1 growth rate is based on *Value Lines*'s projected dividends for the next twelve
13 months, when available, and on the average dividend growth rate (5.0 percent) calculated
14 in Staff's constant DCF analysis for the remainder of the stage.

1 **Q. How did Staff estimate long-term (stage-2) growth?**

2 A. Staff calculated the stage-2 growth rate using the arithmetic mean rate of growth in GDP
3 from 1929 to 2009.⁶ Using the GDP growth rate assumes that the water utility industry is
4 expected to grow at the same rate as the overall economy.

5
6 **Q. What is the historical GDP growth rate that Staff used to estimate stage-2 growth?**

7 A. Staff used 6.6 percent to estimate the stage-2 growth rate.
8

9 **Q. What is Staff's multi-stage DCF estimate for the sample utilities?**

10 A. Staff's multi-stage DCF estimate is 9.7 percent, as shown in Schedule JCM-3.
11

12 **Q. What is Staff's overall DCF estimate for the sample utilities?**

13 A. Staff's overall DCF estimate is 9.0 percent. Staff calculated the overall DCF estimate by
14 averaging the constant growth DCF (8.3 percent) and multi-stage DCF (9.7 percent)
15 estimates, as shown in Schedule JCM-3.
16

17 **Capital Asset Pricing Model**

18 **Q. Please describe the CAPM.**

19 A. The CAPM is used to determine the prices of securities in a competitive market. The
20 CAPM model describes the relationship between a security's investment risk and its
21 market rate of return. Under the CAPM an investor requires the expected return of a
22 security to equal the rate on a risk-free security plus a risk premium. If the investor's
23 expected return does not meet or beat the required return, the investment is not
24 economically justified. The model also assumes that investors will sufficiently diversify

⁶ www.bea.doc.gov

1 their investments to eliminate any non-systematic or unique risk.⁷ In 1990, Professors
2 Harry Markowitz, William Sharpe, and Merton Miller earned the Nobel Prize in
3 Economic Sciences for their contribution to the development of the CAPM.

4
5 **Q. Did Staff use the same sample water utilities in its CAPM and DCF cost of equity**
6 **estimation analyses?**

7 A. Yes. Staff's CAPM cost of equity estimation analysis uses the same sample water
8 companies as its DCF cost of equity estimation analysis.

9
10 **Q. What is the mathematical formula for the CAPM?**

11 A. The mathematical formula for the CAPM is:
12

Equation 8:

$$K = R_f + \beta (R_m - R_f)$$

where: R_f = risk free rate
 R_m = return on market
 β = beta
 $R_m - R_f$ = market risk premium
 K = expected return

13
14 The equation shows that the expected return (K) on a risky asset is equal to the risk-free
15 interest rate (R_f) plus the product of the market risk premium ("Rp") ($R_m - R_f$) multiplied
16 by beta (β) where beta represents the riskiness of the investment relative to the market.

⁷ The CAPM makes the following assumptions: 1) single holding period; 2) perfect and competitive securities market; 3) no transaction costs; 4) no restrictions on short selling or borrowing; 5) the existence of a risk-free rate; and 6) homogeneous expectations.

1 **Q. What is the risk free rate?**

2 A. The risk free rate is the rate of return of an investment with zero risk.

3
4 **Q. What does Staff use as surrogates to represent estimations of the risk-free rates of**
5 **interest in its historical and current market risk premium CAPM methods?**

6 A. Staff uses separate parameters as surrogates for the estimations of the risk-free rates of
7 interest for the historical market risk premium CAPM cost of equity estimation and the
8 current market risk premium CAPM cost of equity estimation. Staff uses the average of
9 three (five-, seven-, and ten-year) intermediate-term U.S. Treasury securities' spot rates in
10 its historical market risk premium CAPM cost of equity estimation, and the 30-year U.S.
11 Treasury bond spot rate in its current market risk premium CAPM cost of equity
12 estimation. U.S. Treasuries are largely verifiable and readily available.

13
14 **Q. What does beta measure?**

15 A. Beta measures the volatility, or systematic risk, of a security relative to the market. Since
16 systematic risk cannot be diversified away, it is the only risk that is relevant when
17 estimating a security's required return. Using a baseline market beta of 1.0, a security
18 with a beta less than 1.0 will be less volatile than the market. A security with a beta
19 greater than 1.0 will be more volatile than the market.

20
21 **Q. How did Staff estimate GWC's beta?**

22 A. Staff used the average of the *Value Line* betas for the sample water utilities as a proxy for
23 GWC's beta. Schedule JCM-7 shows the *Value Line* betas for each of the sample water
24 utilities. The 0.77 average beta for the sample water utilities is Staff's estimated beta for
25 GWC. A security with a 0.77 beta has less volatility than the market.

1 **Q. Please describe expected market risk premium ($R_m - R_f$)?**

2 A. The expected market risk premium is the expected return on the market above the risk free
3 rate. Simplified, it is the return an investor expects as compensation for market risk.

4
5 **Q. What did Staff use for the market risk premium?**

6 A. Staff uses separate calculations for the market risk premium in its historical and current
7 market risk premium CAPM methods.

8
9 **Q. How did Staff calculate an estimate for the market risk premium in its historical**
10 **market risk premium CAPM method?**

11 A. Staff uses the intermediate-term government bond income returns published in the
12 Ibbotson Associates' *Stocks, Bonds, Bills, and Inflation 2009 Yearbook* to calculate the
13 historical market risk premium. Ibbotson Associates calculates the historical risk
14 premium by averaging the historical arithmetic differences between the S&P 500 and the
15 intermediate-term government bond income returns for the period 1926-2009. Staff's
16 historical market risk premium estimate is 7.2 percent, as shown in Schedule JCM-3.

17
18 **Q. How did Staff calculate an estimate for the market risk premium in its current**
19 **market risk premium CAPM method?**

20 A. Staff solves equation 8 above to arrive at a market risk premium using a DCF derived
21 expected return (K) of 11.53 ($1.8 + 9.73^8$) percent using the expected dividend yield (1.8
22 percent over the next twelve months) and the annual per share growth rate (9.73 percent)
23 that *Value Line* projects for all dividend-paying stocks under its review⁹ along with the
24 current long-term risk-free rate (30-year Treasury note at 4.53 percent) and the market's

⁸ The three to five year price appreciation is 45%. $1.45^{0.25} - 1 = 9.73\%$

⁹ January 28, 2011 issue date.

1 average beta of 1.0. Staff calculated the current market risk premium as 7.00¹⁰ as shown
2 in Schedule JCM-3.

3
4 **Q. What is the result of Staff's historical market risk premium CAPM and current**
5 **market risk premium CAPM cost of equity estimations for the sample utilities?**

6 A. Staff's cost of equity estimates are 8.2 percent using the historical market risk premium
7 CAPM and 9.9 using the current market risk premium CAPM.

8
9 **Q. What is Staff's overall CAPM estimate for the sample utilities?**

10 A. Staff's overall CAPM cost of equity estimate is 9.1 percent which is the average of the
11 historical market risk premium CAPM (8.2 percent) and the current market risk premium
12 CAPM (9.9 percent) estimates, as shown in Schedule JCM-3.

13
14 **VI. SUMMARY OF STAFF'S COST OF EQUITY ANALYSIS**

15 **Q. What is the result of Staff's constant-growth DCF analysis to estimate of the cost of**
16 **equity to the sample water utilities?**

17 A. Schedule JCM-3 shows the result of Staff's constant-growth DCF analysis. The result of
18 Staff's constant-growth DCF analysis is as follows:

19
20
$$k = 3.3\% + 5.0\%$$

21
22
$$k = 8.3\%$$

23 Staff's constant-growth DCF estimate of the cost of equity to the sample water utilities is
24 8.3 percent.

¹⁰ 11.53% = 4.53% + (1) (7.00%)

1 **Q. What is the result of Staff's multi-stage DCF analysis to estimate of the cost of equity**
2 **for the sample utilities?**

3 A. Schedule JCM-9 shows the result of Staff's multi-stage DCF analysis. The result of
4 Staff's multi-stage DCF analysis is:

Applicant	Equity Cost Estimate (k)
American States Water	9.6%
California Water	9.6%
Aqua America	9.3%
Connecticut Water	10.1%
Middlesex Water	10.5%
SJW Corp	<u>9.2%</u>
Average	9.7%

16
17 Staff's multi-stage DCF estimate of the cost of equity for the sample water utilities is 9.7
18 percent.

19
20 **Q. What is Staff's overall DCF estimate of the cost of equity for the sample utilities?**

21 A. Staff's overall DCF estimate of the cost of equity for the sample utilities is 9.0 percent.
22 Staff calculated an overall DCF cost of equity estimate by averaging Staff's constant
23 growth DCF (8.3 percent) and Staff's multi-stage DCF (9.7 percent) estimates, as shown
24 in Schedule JCM-3.

25
26 **Q. What is the result of Staff's historical market risk premium CAPM analysis to**
27 **estimate of the cost of equity for the sample utilities?**

28 A. Schedule JCM-3 shows the result of Staff's CAPM analysis using the historical risk
29 premium estimate. The result is as follows:

30
$$k = 2.7\% + 0.77 * 7.2\%$$

$$k = 8.2\%$$

1 Staff's CAPM estimate (using the historical market risk premium) of the cost of equity to
2 the sample water utilities is 8.2 percent.

3
4 **Q. What is the result of Staff's current market risk premium CAPM analysis to**
5 **estimate the cost of equity for the sample utilities?**

6 A. Schedule JCM-3 shows the result of Staff's CAPM analysis using the current market risk
7 premium estimate. The result is:

8
$$k = 4.5\% + 0.77 * 7.0\%$$

9
$$k = 9.9\%$$

10
11 Staff's CAPM estimate (using the current market risk premium) of the cost of equity to the
12 sample water utilities is 9.9 percent.

13
14 **Q. What is Staff's overall CAPM estimate of the cost of equity for the sample utilities?**

15 A. Staff's overall CAPM estimate for the sample utilities is 9.1 percent. Staff's overall
16 CAPM estimate is the average of the historical market risk premium CAPM (8.2 percent)
17 and the current market risk premium CAPM (9.9 percent) estimates, as shown in Schedule
18 JCM-3.

1 **Q. Please summarize the results of Staff's cost of equity analysis for the sample utilities.**

2 A. The following table shows the results of Staff's cost of equity analysis:

3
4 **Table 2**

Method	Estimate
Average DCF Estimate	9.0%
Average CAPM Estimate	9.1%
Overall Average	9.1%

5

6 Staff's average estimate of the cost of equity to the sample water utilities is 9.1 percent.

7

8 **VII. FINAL COST OF EQUITY ESTIMATES FOR GWC**

9 **Q. Please compare GWC's capital structure to that of the six sample water companies.**

10 A. The average capital structure for the sample water utilities is composed of 47.4 percent
11 equity and 52.6 percent debt, as shown in Schedule JCM-4. GWC's capital structure is
12 composed of 81.4 percent equity and 18.6 percent debt. In this case, since GWC's capital
13 structure is less leveraged than that of the average sample water utilities' capital structure,
14 its stockholders bear less financial risk than the sample water utilities. Accordingly,
15 GWC's cost of equity is lower than that of the sample water utilities.

16

17 **Q. What is Staff's ROE estimate for GWC?**

18 A. Staff determined an ROE estimate of 9.1 percent for the Applicant based on cost of equity
19 estimates for the sample companies ranging from 9.0 percent for the DCF to 9.1 percent
20 for the CAPM.

1 **Q. Why does Staff not use a financial risk adjustment to calculate the effect on the cost**
2 **of equity capital of the different financial risks posed by GWC versus the sample**
3 **companies?**

4 **A.** In this case, Staff does not use a financial risk adjustment because GWC is not a publicly-
5 traded company, and thus, it does not have access to the capital markets.

6
7 **VIII. COST OF DEBT**

8 **Q. What is Staff's Cost of Debt recommendation?**

9 **A.** The Applicant is proposing an 8.5 percent cost of debt representing the interest rate on its
10 loan with its affiliate EC Development. Staff agrees with this cost of debt and
11 recommends that it be adopted.

12
13 **IX. RATE OF RETURN RECOMMENDATION**

14 **Q. What overall rate of return did Staff determine for GWC?**

15 **A.** Staff determined a 9.0 percent ROR for the Applicant, as shown in Schedule JCM-1 and in
16 the following table:

17
18 **Table 3**

19

	Weight	Cost	Weighted Cost
Long-term Debt	18.6%	8.5%	1.6%
Common Equity	81.4%	9.1%	<u>7.4%</u>
Overall ROR			<u>9.0%</u>

X. STAFF RESPONSE TO APPLICANT'S COST OF CAPITAL WITNESS MR. THOMAS J. BOURASSA

Q. Please summarize Mr. Bourassa's analyses and recommendations.

A. Mr. Bourassa recommends a 11.0 percent ROE based on analyses for two constant growth DCF models (Past and Future Growth and Future Only Growth), as well as historical and current market risk premium CAPM for the same sample of water companies selected by Staff. Mr. Bourassa also asserts that GWC faces additional risks not captured by the market models, such as regulatory and financial risk, and he concludes that an 11.0 percent ROE presents a reasonable balance resulting from his analyses. Mr. Bourassa proposes 10.54 percent for the overall ROR with a capital structure consisting of 18.32 percent equity and 81.68 percent debt.

Constant-Growth DCF

Q. Does Mr. Bourassa give equal weight to historical data and analysts' projections to estimate the growth component of his DCF cost of equity estimate?

A. No. Mr. Bourassa's DCF cost of equity estimate is based on the midpoint of his (1) Past and Future Growth estimate and (2) Future Growth estimate. Half of the Past and Future Growth estimate relies on analysts' projections of earnings growth and the entire Future Growth estimate relies on analysts' projections of earnings growth. Thus, choosing the midpoint of the two methods provides analysts' projections with 75 percent of the weight compared to 25 percent for historical data. In addition, Mr. Bourassa's Past and Future Growth estimate provides equal weight to stock price, book value per share, earnings per share and dividends per share. Thus, only one-eighth (12.5 percent) of his method of estimating the dividend growth relies on the growth in dividends per share.

1 **Q. Does Staff have any comments on Mr. Bourassa's heavy reliance on analysts'**
2 **forecasts to estimate DPS growth in his constant growth DCF estimates?**

3 A. Yes. Generally, analysts' forecasts are known to be overly optimistic. Heavy use of
4 analysts' forecasts to calculate the growth in dividends (g), will cause inflated growth, and
5 consequently, inflated cost of equity estimates unless investors give the same strong
6 weight to analysts' forecasts. Also, heavy reliance on analysts' forecasts of earnings
7 growth to forecast DPS is inappropriate because it assumes that investors discount other
8 relevant information such as past dividend and earnings growth.

9
10 **Q. Does Staff have any evidence to support its assertion that heavy reliance on analysts'**
11 **forecasts of earnings growth in the DCF model would result in inflated cost of equity**
12 **estimates?**

13 A. Yes. Experts in the financial community have commented on the optimism in analysts'
14 forecasts of future earnings.¹¹ A study cited by David Dreman in his book *Contrarian*
15 *Investment Strategies: The Next Generation* found that *Value Line* analysts were
16 optimistic in their forecasts by 9 percent annually, on average for the 1987 – 1989 period.
17 Another study conducted by David Dreman found that between 1982 and 1997, analysts
18 overestimated the growth of earnings of companies in the S&P 500 by 188 percent.

19 Also, Burton Malkiel of Princeton University studied the one-year and five-year earnings
20 forecasts made by some of the most respected names in the investment business. His
21 results showed that the five-year estimates of professional analysts, when compared with
22 actual earnings growth rates, were much worse than the predictions from several naïve
23 forecasting models, such as the long-run rate of growth of national income. In the

¹¹ See Seigel, Jeremy J. *Stocks for the Long Run*. 2002. McGraw-Hill. New York. p. 100. Dreman, David. *Contrarian Investment Strategies: The Next Generation*. 1998. Simon & Schuster. New York. pp. 97-98. Malkiel, Burton G. *A Random Walk Down Wall Street*. 2003. W.W. Norton & Co. New York. p. 175. Testimony of Professors Myron J. Gordon and Lawrence I. Gould, consultant to the Trial Staff (Common Carrier Bureau), FCC Docket 79-63, p. 95.

1 following excerpt from Professor Malkiel's book *A Random Walk Down Wall Street*, he
2 discusses the results of his study:

3 When confronted with the poor record of their five-year growth
4 estimates, *the security analysts honestly, if sheepishly, admitted*
5 *that five years ahead is really too far in advance to make reliable*
6 *projections.* They protested that although long-term projections
7 are admittedly important, they really ought to be judged on their
8 ability to project earnings changes one year ahead. Believe it or
9 not, it turned out that their one-year forecasts were even worse than
10 their five-year projections.

11 The analysts fought back gamely. They complained that it was
12 unfair to judge their performance on a wide cross section of
13 industries, because earnings for high-tech firms and various
14 "cyclical" companies are notoriously hard to forecast. *"Try us on*
15 *utilities," one analyst confidently asserted. At the time they were*
16 *considered among the most stable group of companies because of*
17 *government regulation. So we tried it and they didn't like it. Even*
18 *the forecasts for the stable utilities were far off the mark.*¹²
19 (Emphasis added)

20
21 **Q. Are investors aware of the problems related to analysts' forecasts?**

22 **A.** Yes. In addition to books, there are numerous published articles appearing in *The Wall*
23 *Street Journal* and other financial publications that cast doubt as to how accurate research
24 analysts are in their forecasts.¹³ Investors, being keenly aware of these inherent biases in
25 forecasts, will use other methods to assess future growth.

12 Malkiel, Burton G. *A Random Walk Down Wall Street*. 2003. W.W. Norton & Co. New York. p. 175

13 See Smith, Randall & Craig, Suzanne. "Big Firms Had Research Ploy: Quiet Payments Among Rivals." *The Wall Street Journal*. April 30, 2003. Brown, Ken. "Analysts: Still Coming Up Rosy." *The Wall Street Journal*. January 27, 2003. p. C1. Karmin, Craig. "Profit Forecasts Become Anybody's Guess." *The Wall Street Journal*. January 21, 2003. p. C1. Gasparino, Charles. "Merrill Lynch Investigation Widens." *The Wall Street Journal*. April 11, 2002. p. C4. Elstein, Aaron. "Earnings Estimates Are All Over the Map." *The Wall Street Journal*. August 2, 2001. p. C1. Dreman, David. "Don't Count on those Earnings Forecasts." *Forbes*. January 26, 1998. p. 110.

1 **Q. Does Staff have any comments on the study cited by Mr. Bourassa, conducted by**
2 **David A. Gordon, Myron J. Gordon and Lawrence I. Gould¹⁴ that he asserts**
3 **supports heavy use of analysts' forecasts in the DCF model?**

4 **A.** Yes. The article cited by Mr. Bourassa does not conclude that investors ignore or heavily
5 discount past growth when pricing stocks. Instead, the article describes more generally
6 that methods exclusively using analysts' forecasts are "popular or attractive models", but
7 the article does not support the conclusion that these forecasts should be used alone or as
8 the primary estimates.

9
10 **Q. Does Professor Gordon recommend relying exclusively on analysts' forecasts as the**
11 **measure of growth in the DCF model?**

12 **A.** No. Subsequent to the study cited by Mr. Bourassa,¹⁵ Professor Gordon provided the
13 keynote address at the 30th Financial Forum of the Society of Utility and Regulatory
14 Financial Analysts, in which he stated:

15 I understand that companies coming before regulatory agencies
16 liked and advocated the high growth rates in security analyst
17 forecasts for arriving at their cost of equity capital. Instead of
18 rejecting these forecasts, I understand that FERC and other
19 regulatory agencies have decided to compromise with them. In
20 particular, in arriving at the cost of equity for company X, the
21 FERC has decided to arrive at the growth rate in my dividend
22 growth model by using an average of two growth rates. One is
23 security analysts forecast of the short-term growth rate in earnings
24 provided by IBES or Value Line and the other a more long run and
25 typically lower figure such as the past growth in GNP.

26 Such an average can be questioned on various grounds. However,
27 my judgment is that between the short-term forecast alone and its

¹⁴ Gordon, David A., Myron J. Gordon, Lawrence I. Gould. "Choice Among Methods of Estimating Share Yield." *The Journal of Portfolio Management*. Spring 1989. pp. 50-55. (Bourassa's direct testimony, page 28, footnote.)

¹⁵ Ibid.

1 average with the past growth rate in GNP, *the latter may be a more*
2 *reasonable figure.*¹⁶ (Emphasis added)

3
4 Simply stated, Professor Gordon would temper the typically higher analysts' forecasts
5 with the typically lower GNP growth rate by averaging the two.

6
7 **Q. How does Staff respond to Mr. Bourassa's statement, "Logically, in estimating future**
8 **growth, financial institutions and analysts have taken into account all relevant**
9 **historical information on a company as well as other more recent information. To**
10 **the extent that past results provide useful indications of future growth prospects,**
11 **analysts' forecasts would already incorporate that information"? (Bourassa's Direct**
12 **Testimony, Page 28, line 1-4)**

13 **A.** The appropriate growth rate to use in the DCF formula is the dividend growth rate
14 expected by *investors*, not analysts. Therefore, while analysts may have considered
15 historical measures of growth, it is reasonable to assume that investors rely to some extent
16 on past growth as well. This calls for consideration of both analysts' forecasts as well as
17 past growth.

18
19 **Q. Does Staff have any comments on Mr. Bourassa's slight reliance on historical DPS**
20 **growth to estimate DPS growth constant growth DCF estimates?**

21 **A.** Yes. As previously stated on section V of this testimony, the current market price of a
22 stock is equal to the present value of all expected future dividends, not future earnings.
23 Professor Jeremy Siegel from the Wharton School of Finance stated:

¹⁶ Gordon, M. J. Keynote Address at the 30th Financial Forum of the Society of Utility and Regulatory Financial Analysts. May 8, 1998. Transparency 3.

1 Note that the price of the stock is always equal to the present value
2 of all future *dividends* and not the present value of future earnings.
3 Earnings not paid to investors can have value only if they are paid
4 as dividends or other cash disbursements at a later date. Valuing
5 stock as the present discounted value of future earnings is
6 manifestly wrong and greatly overstates the value of the firm.¹⁷
7

8 In other words, investors pay attention to earnings as long as they are paid as dividends.
9 Earnings can easily be overstated. If investors do not receive dividends or other cash
10 disbursement at a later date, then such earnings are meaningless. Accordingly, historical
11 DPS growth should receive appropriate consideration in the estimation of DPS growth
12 component of the DCF cost of equity estimation model.
13

14 **Q. Does Staff have any comment on data in Mr. Bourassa Schedule D-4.4 which he uses**
15 **to calculate a DCF dividend growth rate in his Past and Future DCF method?**

16 A. Yes. Schedule D-4.4 presents calculations based on five years of historical data. Using
17 only five years of data could result in significant variances in the outcomes due to a single
18 high or low data point. A larger number of data points, i.e., use of more years, is usually
19 preferable. Also, five years may be too limited to capture a full business cycle, resulting
20 in unnecessary skewing of the outcomes.

¹⁷ Seigel, Jeremy J. Stocks for the Long Run. 2002. McGraw-Hill. New York. P. 93.

1 **Firm-Specific Risk**

2 **Q. Does Staff have any comment on Mr. Bourassa's statement that "Arizona water (and**
3 **wastewater) utilities face legal constraints that limit their ability to obtain rate relief**
4 **outside of a general rate case in which the 'fair value' of the utility's property is**
5 **determined and used to set rates"?¹⁸**

6 **A.** Yes. The unique regulatory environments of the sample companies and GWC are firm-
7 specific risks for which investors cannot expect compensation. None of Mr. Bourassa's
8 comments demonstrate that Arizona is a less favorable regulatory environment from those
9 of the sample companies. Every regulatory jurisdiction has its own framework with its
10 own specific identifiable advantages and disadvantages; however, it is the overall effect
11 that is relevant. Nothing in Mr. Bourassa's testimony provides this overall perspective.
12 The fact that investors continue to acquire Arizona utilities and invest capital in Arizona
13 utilities debunks the notion that the regulatory environment in Arizona places utilities at
14 some disadvantage. The regulatory framework in Arizona has many attractive attributes
15 including: use of fair value rate base, ability to seek accounting orders, recognition of
16 known and measurable changes, wide use of hook-up fees and regulatory responsiveness
17 to utility industry concerns (e.g., arsenic cost recovery mechanisms and arsenic remedial
18 surcharge mechanisms).

19

¹⁸ Direct Testimony of Thomas J. Bourassa, Goodman Water Company, Docket No. W-02500A-10-0382, page 19 lines 5-8

1 **Q. What is Staff's response to Mr. Bourassa's contention that the market data provided**
2 **by the sample water utilities does not capture all of the market risk associated with**
3 **GWC due to Arizona regulatory requirements' use of historical test years and**
4 **limited out of period adjustment recognition?**¹⁹

5 **A.** The examples cited by Mr. Bourassa are examples of firm-specific or unique risks.
6 Existence of firm-specific risk does not necessarily indicate that a company has more total
7 risk than others, as all companies have firm-specific risks. Moreover, as previously
8 discussed, the market does not compensate investors for firm-specific risk because it can
9 be eliminated through diversification.

10
11 **Q. Does Staff have a response to Mr. Bourassa's citation that "[i]n Chapter 7 of**
12 **Morningstar's Ibbotson SBBI 2009 Valuation Yearbook, for example, Ibbotson**
13 **reports that when betas (a measure of market risk) are properly estimated, betas are**
14 **larger for smaller companies than for larger companies"**²⁰?

15 **A.** Yes. It is generally understood that smaller companies tend to have higher betas than
16 larger companies due to larger variations in earnings thus making the smaller companies
17 more risky.

¹⁹ Direct Testimony of Thomas J. Bourassa, Goodman Water Company, Docket No. W-02500A-10-0382, page 19 lines 12-13

²⁰ Direct Testimony of Thomas J. Bourassa, Goodman Water Company, Docket No. W-02500A-10-0382, page 31 lines 23-24 and page 32 line 1

1 **Q. What is Staff's response to Mr. Bourassa's contention that GWC should receive a**
2 **higher cost of equity estimate because of its smaller size through a "company specific**
3 **risk premium"**²¹ **and to his assertion that GWC is not comparable to the six publicly-**
4 **traded water utilities in the sample group due to a difference in size?**²²

5 A. Staff does not agree that GWC should be allowed a small firm risk premium. No
6 generally-accepted analysis demonstrates that utilities are subject to the same size-
7 dependent betas as the general market. The Commission has previously ruled that firm
8 size does not warrant recognition of a risk premium. In Decision No. 64282, dated
9 December 28, 2001, for Arizona Water, the Commission stated, "We do not agree with the
10 Company's proposal to assign a risk premium to Arizona Water based on its size relative
11 to other publicly traded water utilities...." In Decision No. 64727, dated April 17, 2002,
12 for Black Mountain Gas, the Commission agreed with Staff that "the 'firm size
13 phenomenon' does not exist for regulated utilities, and that therefore there is no need to
14 adjust for risk for small firm size in utility rate regulation."
15

16 **XI. CONCLUSION**

17 **Q. Please summarize Staff's recommendations.**

18 A. Staff recommends that the Commission adopt a capital structure for GWC in this
19 proceeding composed of 18.6 percent debt and 81.4 percent equity.
20

21 Staff also recommends that the Commission adopt a 9.0 percent ROR for the Applicant,
22 based on Staff's cost of equity estimates that range from 9.0 percent to 9.1 percent for the
23 sample companies and a 8.5 percent cost of debt.

²¹ Direct Testimony of Thomas J. Bourassa, Goodman Water Company, Docket No. W-02500A-10-0382, page 38 lines beginning line 19

²² Direct Testimony of Thomas J. Bourassa, Goodman Water Company, Docket No. W-02500A-10-0382, page 38 lines 20-21

1 **Q. Does this conclude your direct testimony?**

2 **A. Yes, it does.**

3

Goodman Water Company Cost of Capital Calculation
Capital Structure
And Weighted Average Cost of Capital
Staff Recommended and Company Proposed

[A]	[B]	[C]	[D]
<u>Description</u>	<u>Weight (%)</u>	<u>Cost</u>	<u>Weighted Cost</u>
Staff Recommended Structure			
Debt	18.6%	8.5%	1.6%
Common Equity	81.4%	9.1%	7.4%
Weighted Average Cost of Capital			9.0%
Company Proposed Structure			
Debt	18.3%	8.5%	1.6%
Common Equity	81.7%	11.0%	9.0%
Weighted Average Cost of Capital			10.5%

[D] : [B] x [C]
 Supporting Schedules: JCM-3 and JCM-4.

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Goodman Water Company Cost of Capital Calculation
Average Capital Structure of Sample Water Utilities

[A]	[B]	[C]	[D]
<u>Company</u>	<u>Debt</u>	Common <u>Equity</u>	<u>Total</u>
American States Water	49.7%	50.3%	100.0%
California Water	49.8%	50.2%	100.0%
Aqua America	56.0%	44.0%	100.0%
Connecticut Water	57.0%	43.0%	100.0%
Middlesex Water	49.7%	50.3%	100.0%
SJW Corp	<u>53.6%</u>	<u>46.4%</u>	<u>100.0%</u>
Average Sample Water Utilities	52.6%	47.4%	100.0%
GWC - Actual Capital Structure	18.6%	81.4%	100.0%

Source:
Sample Water Companies from Value Line

Goodman Water Company Cost of Capital Calculation
Growth in Earnings and Dividends
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]
<u>Company</u>	Dividends Per Share 2000 to 2010 <u>DPS¹</u>	Dividends Per Share Projected <u>DPS¹</u>	Earnings Per Share 2000 to 2010 <u>EPS^{1,2}</u>	Earnings Per Share Projected <u>EPS¹</u>
American States Water	1.9%	3.6%	6.2%	3.0%
California Water	0.8%	0.7%	4.0%	6.5%
Aqua America	7.7%	4.9%	6.7%	5.0%
Connecticut Water	1.3%	No Projection	1.5%	No Projection
Middlesex Water	1.7%	No Projection	2.1%	No Projection
SJW Corp	<u>5.1%</u>	<u>No Projection</u>	<u>1.2%</u>	<u>No Projection</u>
Average Sample Water Utilities	3.1%	3.1%	4.6%	4.9%

¹ Value Line

² Negative values are inconsistent with the DCF, accordingly, they are excluded from the average.

Goodman Water Company Cost of Capital Calculation
Sustainable Growth
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]
Company	Retention Growth 2001 to 2010 br	Retention Growth Projected br	Stock Financing Growth vs	Sustainable Growth 2001 to 2010 br + vs	Sustainable Growth Projected br + vs
American States Water	2.9%	5.8%	1.8%	4.8%	7.6%
California Water	2.2%	6.1%	3.9%	6.1%	10.0%
Aqua America	4.5%	5.0%	4.5%	9.1%	9.5%
Connecticut Water	2.5%	No Projection	0.9%	3.4%	No Projection
Middlesex Water	1.4%	No Projection	3.3%	4.7%	No Projection
SJW Corp	<u>4.1%</u>	<u>No Projection</u>	<u>0.1%</u>	<u>4.2%</u>	<u>No Projection</u>
Average Sample Water Utilities	2.9%	5.6%	2.4%	5.4%	9.1%

[B]: Value Line

[C]: Value Line

[D]: Value Line and MSN Money

[E]: [B]+[D]

[F]: [C]+[D]

Goodman Water Company Cost of Capital Calculation
Selected Financial Data of Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]	[G]
	<u>Symbol</u>	<u>Spot Price</u> 1/19/2011	<u>Book Value</u>	<u>Mkt To</u> <u>Book</u>	<u>Value Line</u> Beta β	<u>Raw</u> Beta β_{raw}
	American States Water	34.53	20.35	1.7	0.80	0.67
	California Water	37.63	21.13	1.8	0.70	0.52
	Aqua America	23.18	8.46	2.7	0.65	0.45
	Connecticut Water	25.95	12.67	2.0	0.80	0.67
	Middlesex Water	18.45	10.76	1.7	0.75	0.60
	SJW Corp	25.19	14.42	<u>1.7</u>	<u>0.90</u>	<u>0.82</u>
	Average			2.0	0.77	0.62

[C]: Men Money

[D]: Value Line

[E]: [C] / [D]

[F]: Value Line

[G]: $(-0.35 + [F]) / 0.67$

Goodman Water Company Cost of Capital Calculation
Calculation of Expected Infinite Annual Growth in Dividends
Sample Water Utilities

[A]	[B]
<u>Description</u>	<u>g</u>
DPS Growth - Historical ¹	3.1%
DPS Growth - Projected ¹	3.1%
EPS Growth - Historical ¹	4.6%
EPS Growth - Projected ¹	4.9%
Sustainable Growth - Historical ²	5.4%
<u>Sustainable Growth - Projected²</u>	<u>9.1%</u>
Average	5.0%

¹ Schedule JCM-5

² Schedule JCM-6

Goodman Water Company Cost of Capital Calculation
Multi-Stage DCF Estimates
Sample Water Utilities

[A] Company	[B] Current Mkt. Price (P_0) ¹ 1/19/2011	[C]	[D]	[E]	[F]	[H]	[I]
		Projected Dividends ² (Stage 1 growth) (D_t)			Stage 2 growth ³ (g_n)		Equity Cost Estimate (K) ⁴
		d_1	d_2	d_3	d_4		
American States Water	34.5	1.08	1.13	1.19	1.25	6.6%	9.6%
California Water	37.6	1.19	1.25	1.31	1.38	6.6%	9.6%
Aqua America	23.2	0.64	0.68	0.71	0.75	6.6%	9.3%
Connecticut Water	26.0	0.96	1.00	1.05	1.11	6.6%	10.1%
Middlesex Water	18.5	0.76	0.80	0.84	0.88	6.6%	10.5%
SJW Corp	25.2	0.68	0.71	0.75	0.79	6.6%	9.2%

Average 9.7%

$$P_0 = \sum_{t=1}^n \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K - g_n} \left[\frac{1}{(1+K)} \right]^n$$

Where : P_0 = current stock price

D_t = dividends expected during stage 1

K = cost of equity

n = years of non - constant growth

D_n = dividend expected in year n

g_n = constant rate of growth expected after year n

¹ [B] see Schedule JCM-7

² Derived from Value Line Information

³ Average annual growth in GDP 1923 - 2009 in current dollars.

⁴ Internal Rate of Return of Projected Dividends

BEFORE THE ARIZONA CORPORATION COMMISSION

GARY PIERCE
Chairman
BOB STUMP
Commissioner
SANDRA D. KENNEDY
Commissioner
PAUL NEWMAN
Commissioner
BRENDA BURNS
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. W-02500A-10-0382
GOODMAN WATER COMPANY, AN)
ARIZONA CORPORATION, FOR (i) A)
DETERMINATION OF THE FAIR VALUE)
OF ITS UTILITY PLANT AND PROPERTY)
AND (ii) AN INCREASE IN ITS WATER RATES)
AND CHARGES FOR UTILITY SERVICE)
BASED THEREON.)

SURREBUTTAL

TESTIMONY

OF

JUAN C. MANRIQUE

PUBLIC UTILITIES ANALYST I

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JUNE 13, 2011

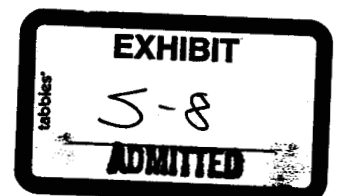


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**EXECUTIVE SUMMARY
GOODMAN WATER COMPANY
DOCKET NO. W-02500A-10-0382**

The Surrebuttal Testimony of Staff witness Juan C. Manrique addresses the following issues:

Capital Structure – Staff continues to recommend that the Commission adopt a capital structure for Goodman Water Company (“Applicant”) for this proceeding consisting of 18.6 percent debt and 81.4 percent equity.

Cost of Equity – Staff recommends that the Commission adopt a 9.3 percent return on equity (“ROE”) for the Applicant. Staff’s estimated ROE for the Applicant is based on cost of equity estimates for the sample companies ranging from 9.2 percent for the discounted cash flow method (“DCF”) to 9.3 percent for the capital asset pricing model (“CAPM”).

Cost of Debt – Staff continues to recommend, that the Commission adopt an 8.5 percent cost of debt.

Overall Rate of Return – Staff recommends that the Commission adopt an overall rate of return (“ROR”) of 9.2 percent.

Response to the Rebuttal Testimony of Applicant’s witness Mr. Thomas J. Bourassa - The Commission should reject the Company’s proposals to allow for a firm size adjustment and to rely heavily on analysts’ forecasts for DCF estimates as well as forecasted U.S. Treasury rates for Historical Market Risk Premium CAPM results.

Response to the Rebuttal Testimony of Applicant’s witness Mr. James Schoemperlen – Water utilities have limited access to long-term, low interest refinancing. Accordingly, the Commission should use the Applicant’s actual 8.5 percent interest rate as the cost of debt used to determine the rate of return.

I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Juan C. Manrique. I am a Public Utilities Analyst employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Are you the same Juan C. Manrique who filed direct testimony in this case?

A. Yes, I am.

Q. What is the purpose of your Surrebuttal Testimony in this rate proceeding?

A. The purpose of my Surrebuttal Testimony in this rate proceeding is to report on Staff's updated cost of capital analysis with its recommendations regarding Goodman Water Company's ("GWC" or "Applicant") cost of capital and to respond to the cost of capital portion of the rebuttal testimony of GWC's witness Mr. Thomas J. Bourassa ("Mr. Bourassa's Rebuttal").

Q. Please explain how Staff's Surrebuttal Testimony for cost of capital is organized.

A. Staff's surrebuttal testimony for cost of capital is presented in four sections. Section I is this introduction. Section II discusses Staff's updated cost of capital analysis. Section III presents Staff's comments on Mr. Bourassa's rebuttal testimony. Section IV presents Staff's comments on intervenor Mr. Shoemperlen's rebuttal testimony. Lastly, Section V presents Staff's recommendations.

II. COST OF EQUITY AND OVERALL RATE OF RETURN

Q. Did Staff update its analysis concerning the Applicant's cost of equity ("COE") since it filed its Direct Testimony?

A. Yes. Staff updated its analysis to include the most updated data available.

Q. What is Staff's updated COE?

A. Staff's updated COE is 9.3 percent. In Staff's direct testimony, the COE was 9.1 percent.

Q. What is Staff recommending for GWC's COE?

A. Staff is recommending a COE of 9.3 percent derived from its updated cost of equity estimates that range from 9.2 percent to 9.3 percent.

Q. Did Staff update its analysis concerning the Applicant's overall rate of return?

A. Yes.

Q. What is Staff's updated overall rate of return?

A. Staff's updated overall rate of return is 9.2 percent.

Q. What is Staff recommending for GWC's overall rate of return?

A. Staff is recommending an overall rate of return of 9.2 percent. Staff's recommendation is based on a COE of 9.3 percent, a cost of debt of 8.5 percent and a capital structure of 81.4 percent equity and 18.6 percent debt, as shown in Surrebuttal Schedule JCM-1.

1 **III. RESPONSE TO THE REBUTTAL TESTIMONY OF THE APPLICANT'S COST**
2 **OF CAPITAL WITNESS**

3 **Q. Does Staff have a response to Mr. Bourassa's argument that Staff's COE**
4 **recommendation is too low when compared to the Commission's authorized COE of**
5 **10.3 percent in the recent Sahuarita case?¹**

6 A. Yes. As Mr. Bourassa mentions later in his testimony,² Staff's final analysis in the
7 Sahuarita case was done in June of 2010. Since Staff's methodology has not changed in
8 the intervening time, the difference is related completely to changes in investor
9 expectations.

10
11 **Q. Does Staff have a response to Mr. Bourassa's assertion that "the importance of**
12 **analyst estimates is that they reflect widely held investor expectations"?³**

13 A. Yes. While Mr. Bourassa has demonstrated that these estimates reflect widely-held
14 analyst estimates, it has not been demonstrated that these estimates are widely-held by
15 *investors*. As discussed in my direct testimony, there are numerous published books and
16 articles that cast doubt on the accuracy of research analysts' forecasts.⁴ Investors, being
17 keenly aware of these inherent biases in forecasts, will use other methods to assess future
18 growth.

¹ Mr. Bourassa's Rebuttal page 13.

² Mr. Bourassa's Rebuttal page 13, lines 20-22.

³ Mr. Bourassa's Rebuttal page 18, lines 7-8.

⁴ Mr. Manrique's Direct page 37, lines 9-13.

1 **Q. How does Staff respond to Mr. Bourassa's reference to several studies used by Mr.**
2 **Gary Hayes in a San Diego Gas & Electric case that address whether analysts growth**
3 **forecasts are overly optimistic?**⁵

4 **A. In a more recent article from the McKinsey Quarterly which is published by McKinsey &**
5 **Company (Attachment A), the authors' state:**

6
7 To better understand their (analysts) accuracy, we undertook
8 research nearly a decade ago that produced sobering results. Analysts,
9 we found, were typically overoptimistic, slow to revise their forecasts
10 to reflect new economic conditions, and prone to making increasingly
11 inaccurate forecasts when economic growth declined.

12 Also:

13 Only in years such as 2003 to 2006, when strong economic growth
14 generated actual earnings that caught up with earlier predictions, do
15 forecasts actually hit the mark. This pattern confirms our earlier findings
16 that analysts typically lag behind events in revising their forecasts to
17 reflect new economic conditions...So as economic growth cycles up
18 and down, the actual S&P 500 companies report occasionally coincide
19 with the analysts' forecasts, as they did, for example, in 1988, from 1994
20 to 1997, and from 2003 to 2006.

21
22 What this demonstrates is that, outside of economic boom years, analysts' estimates are
23 overly optimistic. That these estimates occasionally coincide with actual earnings does
24 not disprove the widely held view that analysts' estimates are overly optimistic. One can
25 only conclude that investors have this information and take it into account when making
26 investment decisions.

⁵ Mr. Bourassa's Rebuttal page 18 and Exhibit TJB-COC-RB3.

1 **Q. Does Staff have a response to Mr. Bourassa's assertion that firm size is a systematic**
2 **risk factor⁶?**

3 A. Yes. While firm size may be a factor in COE estimation, it has not been demonstrated that
4 this is true for regulated utilities, therefore Staff rejects this assertion. As previously
5 stated, Staff does not agree that the Company should receive a size risk adjustment.
6

7 **IV. RESPONSE TO THE REBUTTAL TESTIMONY OF INTERVENOR**
8 **SCHOEMPERLEN**

9 **Q. How does Staff respond to Mr. Schoemperlen's assertion that Staff "cherry picked"⁷**
10 **the sample companies used as a proxy for GWC's COE estimation in the current**
11 **case?**

12 A. Staff has chosen these proxy companies due to their characteristics as mainly engaging in
13 regulated water operations and the availability of their financial information. If Staff were
14 "cherry picking" companies in order to bias the COE results, one would expect the sample
15 companies to change frequently over time. Yet, Staff has essentially used the same six
16 companies since, at least, the early 2000's. The only change Staff made was eliminating
17 Philadelphia Suburban and adding Aqua America due to the latter's acquisition of
18 Philadelphia Suburban.
19

20 **Q. Does Staff have a response to Mr. Schoemperlen's contention that there should be a**
21 **downward adjustment in GWC's COE due to its less leveraged capital structure?⁸**

22 A. Yes. As previously stated,⁹ Staff does not use a financial risk adjustment because GWC is
23 not a publicly-traded company, and thus, it does not have access to the capital markets.

⁶ Mr. Bourassa's Rebuttal, page 24, line 13.

⁷ Mr. Shoemperlen's Rebuttal, page 4, line 49.

⁸ Mr. Schoemperlen's Rebuttal, page 4, lines 51-56, page 5, lines 76-88

⁹ Mr. Manrique's Direct Testimony, page 34, lines 4-5

1 **Q. What is Staff's response to Mr. Schoemperlen's objection to Staff's acceptance of**
2 **GWC's 8.5 percent cost of debt due to it being held by an affiliate?**

3 A. Water utilities historically have had limited access to long-term debt financing. Even
4 when banks and other lending institutions offer loans to water utilities, the term is
5 relatively short and the interest rate similar to that GWC is experiencing with its existing
6 loan. Although low interest loans are often available from the Water Infrastructure
7 Financing Authority of Arizona ("WIFA") for initial construction, WIFA does not offer
8 refinancing of existing loans. Accordingly, Staff concludes that as 8.5 percent is GWC's
9 actual cost of debt, this is the appropriate cost of debt to use when determining the
10 Company's rate of return.
11

12 **V. STAFF RECOMMENDATIONS**

13 **Q. What are Staff's recommendations for GWC's cost of capital?**

14 A. Staff makes the following recommendations for GWC's cost of capital:

- 15 1. Staff recommends a capital structure of 18.6 percent debt and 81.4 percent equity.
 - 16 2. Staff recommends a cost of debt of 8.5 percent.
 - 17 3. Staff recommends a cost of equity of 9.3 percent.
 - 18 4. Staff recommends an overall rate of return of 9.2 percent.
- 19

20 **Q. Does this conclude your testimony?**

21 A. Yes, it does.

**Goodman Water Company Cost of Capital Calculation
Capital Structure
And Weighted Average Cost of Capital
Staff Recommended and Company Proposed**

[A]	[B]	[C]	[D]
<u>Description</u>	<u>Weight (%)</u>	<u>Cost</u>	<u>Weighted Cost</u>
Staff Recommended Structure			
Debt	18.6%	8.5%	1.6%
Common Equity	81.4%	9.3%	7.6%
Weighted Average Cost of Capital			<u>9.2%</u>
Company Proposed Structure			
Debt	18.3%	8.5%	1.6%
Common Equity	81.7%	10.2%	8.3%
Weighted Average Cost of Capital			<u>9.9%</u>

[D] : [B] x [C]

Supporting Schedules: JCM-3 and JCM-4.

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Goodman Water Company Cost of Capital Calculation
Average Capital Structure of Sample Water Utilities

[A]	[B]	[C]	[D]
<u>Company</u>	<u>Debt</u>	Common <u>Equity</u>	<u>Total</u>
American States Water	49.8%	50.2%	100.0%
California Water	53.4%	46.6%	100.0%
Aqua America	57.2%	42.8%	100.0%
Connecticut Water	55.9%	44.1%	100.0%
Middlesex Water	49.4%	50.6%	100.0%
SJW Corp	<u>53.4%</u>	<u>46.6%</u>	<u>100.0%</u>
Average Sample Water Utilities	53.2%	46.8%	100.0%
GWC - Actual Capital Structure	18.6%	81.4%	100.0%

Source:

Sample Water Companies from Value Line

Goodman Water Company Cost of Capital Calculation
Growth in Earnings and Dividends
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]
Company	Dividends Per Share 2000 to 2010 <u>DPS¹</u>	Dividends Per Share Projected <u>DPS¹</u>	Earnings Per Share 2000 to 2010 <u>EPS^{1,2}</u>	Earnings Per Share Projected <u>EPS¹</u>
American States Water	1.9%	3.7%	6.2%	2.2%
California Water	0.8%	3.0%	4.0%	4.0%
Aqua America	7.7%	6.0%	6.7%	8.4%
Connecticut Water	1.5%	No Projection	0.9%	No Projection
Middlesex Water	1.8%	No Projection	2.4%	No Projection
SJW Corp	<u>5.2%</u>	<u>3.8%</u>	<u>3.8%</u>	<u>9.1%</u>
Average Sample Water Utilities	3.2%	4.1%	4.4%	6.0%

¹ Value Line

² Negative values are inconsistent with the DCF, accordingly, they are excluded from the average.

Goodman Water Company Cost of Capital Calculation
Sustainable Growth
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]
Company	Retention Growth 2001 to 2010 br	Retention Growth Projected br	Stock Financing Growth vs	Sustainable Growth 2001 to 2010 br + vs	Sustainable Growth Projected br + vs
American States Water	3.1%	6.7%	1.7%	4.9%	8.4%
California Water	2.2%	4.2%	3.8%	6.0%	8.1%
Aqua America	4.5%	5.5%	4.4%	8.9%	9.9%
Connecticut Water	2.3%	No Projection	0.9%	3.2%	No Projection
Middlesex Water	1.3%	No Projection	4.2%	5.4%	No Projection
SJW Corp	<u>3.9%</u>	<u>2.8%</u>	<u>0.1%</u>	<u>4.0%</u>	<u>2.9%</u>
Average Sample Water Utilities	2.9%	4.8%	2.5%	5.4%	7.3%

[B]: Value Line

[C]: Value Line

[D]: Value Line and MSN Money

[E]: [B]+[D]

[F]: [C]+[D]

Goodman Water Company Cost of Capital Calculation
Selected Financial Data of Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]	[G]
Company	Symbol	Spot Price 5/11/2011	Book Value	Mkt To Book	Value Line Beta β	Raw Beta β_{raw}
American States Water	AWR	33.57	20.36	1.6	0.75	0.60
California Water	CWT	36.75	21.05	1.7	0.70	0.52
Aqua America	WTR	22.99	8.65	2.7	0.65	0.45
Connecticut Water	CTWS	25.24	12.78	2.0	0.80	0.67
Middlesex Water	MSEX	18.62	10.91	1.7	0.75	0.60
SJW Corp	SJW	22.80	14.57	1.6	0.90	0.82
Average				1.9	0.76	0.61

[C]: Msn Money

[D]: Value Line

[E]: [C] / [D]

[F]: Value Line

[G]: $(-0.35 + [F]) / 0.67$

Goodman Water Company Cost of Capital Calculation
Calculation of Expected Infinite Annual Growth in Dividends
Sample Water Utilities

[A]	[B]
Description	g
DPS Growth - Historical ¹	3.2%
DPS Growth - Projected ¹	4.1%
EPS Growth - Historical ¹	4.4%
EPS Growth - Projected ¹	6.0%
Sustainable Growth - Historical ²	5.4%
<u>Sustainable Growth - Projected²</u>	<u>7.3%</u>
Average	5.1%

¹ Schedule JCM-5
² Schedule JCM-6

Goodman Water Company Cost of Capital Calculation
Multi-Stage DCF Estimates
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]	[H]	[I]
Company	Current Mkt. Price (P_0) ¹ 5/11/2011	Projected Dividends ² (Stage 1 growth) (D_t)				Stage 2 growth ³ (g_n)	Equity Cost Estimate (K) ⁴
American States Water	33.6	d_1	d_2	d_3	d_4	6.6%	9.6%
California Water	36.8	1.07	1.12	1.18	1.24	6.6%	9.9%
Aqua America	23.0	1.28	1.34	1.41	1.48	6.6%	9.2%
Connecticut Water	25.2	0.64	0.67	0.70	0.74	6.6%	10.2%
Middlesex Water	18.6	0.94	0.99	1.04	1.09	6.6%	10.5%
SJW Corp	22.8	0.75	0.79	0.83	0.87	6.6%	9.6%
		0.72	0.75	0.79	0.83	6.6%	

Average **9.9%**

$$P_0 = \sum_{t=1}^n \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K - g_n} \left[\frac{1}{(1+K)} \right]^n$$

Where : P_0 = current stock price

D_t = dividends expected during stage 1

K = cost of equity

n = years of non – constant growth

D_n = dividend expected in year n

g_n = constant rate of growth expected after year n

¹ [B] see Schedule JCM-7

² Derived from Value Line Information

³ Average annual growth in GDP 1923 - 2010 in current dollars.

⁴ Internal Rate of Return of Projected Dividends

BEFORE THE ARIZONA CORPORATION COMMISSION

GARY PIERCE
Chairman

BOB STUMP
Commissioner

SANDRA D. KENNEDY
Commissioner

PAUL NEWMAN
Commissioner

BRENDA BURNS
Commissioner

IN THE MATTER OF THE APPLICATION OF)
GOODMAN WATER COMPANY FOR AN)
INCREASE IN ITS WATER RATES)
FOR CUSTOMERS WITHIN PINAL)
COUNTY, ARIZONA)
_____)

DOCKET NO. W-02500A-10-0382

DIRECT

TESTIMONY

OF

GARY T. MCMURRY

PUBLIC UTILITIES ANALYST IV

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MARCH 21, 2011

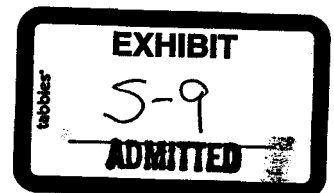


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**EXECUTIVE SUMMARY
GOODMAN WATER COMPANY
DOCKET NO. W-02500A-10-0382**

Goodman Water Company ("Goodman" or "Company") is an Arizona for-profit, Class C public service corporation providing water service to approximately 600 customers in the vicinity of Oracle in Pinal County, Arizona. On September 17, 2010, Goodman filed a general rate application. The application shows that Goodman posted a \$73,882 adjusted operating income for the test year that ended December 31, 2009. Goodman requests a \$291,454 (50.9 percent) revenue increase to provide a \$253,194 operating income for a 10.54 percent rate of return on a \$2,402,222 fair value rate base.

The testimony of Mr. Gary T. McMurphy presents Staff's recommendation in the areas of rate base, operating income, revenue requirement and rate design. Staff recommends a \$120,829 (20.83 percent) revenue increase to provide a \$156,574 operating income for a 9.0 percent rate of return on a \$1,739,712 fair value rate base. Staff's recommendation reflects six rate base adjustments for a \$662,510 reduction and five operating income adjustments for a \$13,175 increase in adjusted test year operating income.

The present rate structure for the residential, commercial, and construction customer classes consists of an inverted three-tier commodity rate for 5/8 x 3/4-inch and 3/4-inch meters. An inverted two-tier commodity rate structure applies to larger meters. A minimum monthly fixed charge that increases by meter size is also applicable to residential and commercial customers.

The Company proposes a rate structure similar to the present rate structure that collects a greater proportion of the revenue from the commodity rates and spreads the rates between the tiers by a greater ratio by increasing the ratio between the first and second tiers for 5/8 x 3/4-inch and 3/4-inch meters. On average, the Company's proposed rates increase by 50.24 percent to achieve its proposed revenue requirement.

Staff also recommends continuation of the fundamental existing rate structure. However, Staff recommends spreading the rates between the tiers by an even greater ratio than proposed by the Company and generating an even greater percentage of the revenue from the commodity rates. Staff's recommended rate design would generate Staff's recommended water revenue requirement of \$700,939 composed of \$687,201 from water services and \$13,738 from other revenues. The typical residential water bill would increase by \$13.55, or 22.2 percent, from \$60.96 to \$74.50.

Staff observed that the Company has engaged in significant transactions with affiliated parties. Staff recommends that Goodman develop policies applicable to transactions with affiliated parties. In addition, due to the fact that Goodman has only one employee, the Company relies heavily on outside contractors. Staff recommends that Goodman develop written policies regarding the hiring and supervision of outside contractors.

1 **I. INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Gary McMurry. I am a Public Utilities Analyst employed by the Arizona
4 Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff").
5 My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Please describe your educational background and professional experience.**

8 A. I received a Bachelor of Science degree in Business Administration with a major in
9 Accounting from the University of Arizona. I have since been awarded two professional
10 designations, as a Certified Fraud Examiner and as a Certified Internal Auditor; after
11 successfully meeting the prescribed requirements established by each of the sponsoring
12 professional organizations.

13
14 My prior work experience includes approximately 20 years of auditing (both internal and
15 external), five additional years as a bank examiner, and two years of Investigations work.
16 Prior to joining the Commission, I was employed by the Office of Audit and Analysis for
17 the Department of Transportation primarily as a construction auditor.

18
19 In 2007, I began employment at the Commission as a Public Utilities Analyst IV in the
20 Finance and Regulatory Analysis Section. Since coming to the Commission, I have
21 participated in a number of rate cases and other regulatory proceedings involving water
22 and gas utilities. I have also attended various seminars and classes on general regulatory
23 and business issues, including the National Association of Regulatory Utility
24 Commissioners ("NARUC") Utility Rate School and the Institute of Public Utilities
25 Annual Regulatory Studies Program ("Camp NARUC").

1 **Q. Briefly describe your responsibilities as a Public Utilities Analyst.**

2 A. I am responsible for the examination and verification of financial and statistical
3 information included in assigned utility rate applications and other financial regulatory
4 matters. I develop revenue requirements, design rates, and prepare written reports,
5 testimony and schedules to present Staff's recommendations to the Commission.

6
7 **Q. What is the purpose of your testimony in this case?**

8 A. The purpose of my testimony is to present Staff's analysis and recommendations
9 regarding the Goodman Water Company's ("Goodman" or "Company") application for a
10 permanent rate increase. I am presenting recommendations in the areas of rate base,
11 operating income, revenue requirement and rate design. Staff witness Marlin Scott is
12 presenting the engineering analysis and recommendations. Staff witness Juan Manrique is
13 presenting the cost of capital analysis and recommendations.

14
15 **Q. What is the basis of Staff's recommendations?**

16 A. I have performed a regulatory audit of the Company's records to determine whether
17 sufficient, relevant and reliable evidence exists to support the proposals in Goodman's rate
18 application. My regulatory audit consisted of the following: (1) examining and testing
19 Goodman's accounting ledgers, reports and supporting documents; (2) checking the
20 accumulation of amounts in the records; (3) tracing recorded amounts to source
21 documents; and (4) verifying that the Company-applied accounting principles were in
22 accordance with the National Association of Regulatory Utility Commissioners
23 ("NARUC") Uniform System of Accounts ("USOA").

1 **Q. How is your testimony organized?**

2 A. My testimony is presented in nine sections. Section I is this introduction. Section II
3 provides a background of the Company. Section III is a summary of consumer service
4 issues. Section IV is a summary of proposed revenues. Section V is a summary of Staff's
5 rate base and operating income adjustments. Section VI presents Staff's rate base
6 recommendations. Section VII presents Staff's operating income recommendations.
7 Section VIII discusses the Company's current treatment of affiliated party transactions.
8 Section IX discusses rate design.

9
10 **Q. Have you prepared any schedules to accompany your testimony?**

11 A. Yes. I prepared schedules GTM-1 to GTM-20.
12

13 **II. BACKGROUND**

14 **Q. Would you please review the pertinent background information associated with the**
15 **Company's application for a permanent rate increase?**

16 A. Goodman is a class C public service corporation that provides water service to
17 approximately 600 customers in the vicinity of the town of Oracle in Pinal County,
18 Arizona. On September 17, 2010, Goodman filed an application for approval of
19 permanent rates and charges for water service, and on November 5, 2010, Staff filed a
20 letter declaring the application sufficient. Goodman's application asserts that an increase
21 in revenues is required to recover operating expenses and to provide debt service coverage
22 and a 10.54 percent return on fair value rate base ("FVRB").
23

24 **Q. What test year did Goodman use in its filing?**

25 A. Goodman's rate filing is based on the twelve-month period that ended December 31, 2009.

1 **Q. When were Goodman's present rates established?**

2 A. The Commission Decision No. 69404, dated April 16, 2007, granted the Company its
3 present permanent rates.
4

5 **Q. Does Goodman have any other cases currently pending before the Commission?**

6 A. No.
7

8 **III. CONSUMER SERVICE**

9 **Q. Please provide a brief summary of customer complaints received by the Commission**
10 **regarding Goodman Utilities.**

11 A. Staff reviewed the Commission's records for the period January 1, 2008, through March 7,
12 2011, and found 3 complaints and 287 opinions opposed to the rate increase. The
13 Company is in good standing with Corporations Division. The Company is current on all
14 property and sales taxes.
15

16 **IV. SUMMARY OF PROPOSED REVENUES**

17 **Q. What revenue requirement is Goodman proposing?**

18 A. The Company's application proposes total operating revenue of \$864,205, an increase of
19 \$291,454, or 50.89 percent, over its test year revenue of \$572,751. The Company's
20 proposed revenue, as filed, would provide an operating income of \$253,194 for a 10.54
21 percent rate of return on the proposed \$2,402,221 fair value rate base which is the same as
22 the proposed original cost rate base ("OCRB").

1 **Q. What is Staff's revenue requirement recommendation?**

2 A. Staff recommends revenues of \$700,939, a \$120,829 (20.83 percent) increase over test
3 year revenues of \$580,110, to provide an operating income of \$156,574 for a 9.00 percent
4 rate of return on \$1,739,712 FVRB.

5
6 **V. SUMMARY OF STAFF'S RATE BASE AND OPERATING INCOME**
7 **ADJUSTMENTS**

8 **Q. Please summarize Staff's rate base and operating income adjustments.**

9 A. Rate Base:

10 Land Purchase – This adjustment decreases the cost basis of the Company's 2008 land
11 purchase by \$369,500 because this non-arm's-length transaction was based on a flawed
12 appraisal and other factors.

13
14 Reclassify Water Treatment Plant – This adjustment reclassifies \$15,947 in funds from
15 G/L account 320 "Water Treatment Plant" to G/L account 320.2 "Chemical Solution
16 Feeders."

17
18 Reclassify Distribution Reservoirs

19 This adjustment reclassifies \$836,890 from G/L account 330 "Distribution Reservoirs"
20 between two G/L accounts; 330.1 "Storage Tanks" and 330.2 "Pressure Tanks."

21
22 Eliminate the unused and not useful storage tank

23 This adjustment eliminates \$185,049 or approximately one-half of the cost of a 530,000-
24 gallon water storage tank which Staff has deemed to be excess capacity.

1 Eliminate Transmission Mains

2 This adjustment eliminates \$105,564 from transmission mains to reflect lines that Staff
3 has deemed to be not used or useful.

4
5 Adjust accumulated depreciation

6 This adjustment increases the accumulated depreciation balance by \$2,397 to correct for
7 an error in the Company's recorded amount.

8
9 B. Operating Income:

10 Revenue Annualization – This adjustment reverses the Company's \$7,359 negative
11 proforma adjustment because it is not known and measurable, and it is inconsistent with
12 other revenue trends.

13
14 Water Testing Expense – This adjustment increases water testing expense by \$1,568 to
15 reflect Staff's recommended water testing expense.

16
17 Depreciation Expense – This adjustment increases depreciation expense by \$998 to reflect
18 application of Staff's recommended depreciation rates to Staff-recommended plant
19 amounts.

20
21 Property Taxes – This adjustment decreases test year property taxes by \$3,998 to reflect
22 application of the modified version of the Arizona Department of Revenue's property tax
23 methodology which the Commission has consistently adopted.

24

1 Test Year Income Taxes – This adjustment decreases test year income tax expense by
2 \$4,384 to reflect application of statutory state and federal income tax rates to Staff-
3 adjusted taxable income.

4
5 **VI. RATE BASE**

6 **Fair Value Rate Base**

7 **Q. Does Goodman's application include schedules with elements of a Reconstruction**
8 **Cost New Rate Base?**

9 A. No. The Company's application does not request recognition of a Reconstruction Cost
10 New Rate Base. Accordingly, Staff has treated the Company's OCRB as its FVRB.

11
12 **Rate Base Summary**

13 **Q. Please summarize Staff's rate base recommendation.**

14 A. Staff recommends a \$1,739,712 FVRB, a \$662,510 reduction from the Company's
15 proposed \$2,402,222 rate base. Staff's recommendation results from the rate base
16 adjustments described below.

17
18 **Rate Base Adjustment No. 1 – Reduce Cost Basis for Land Purchase**

19 **Q. What did the Company propose with respect to land in the test year?**

20 A. Schedule B-2, page 3, line 7, of the Company's application shows that the Company
21 recorded a balance in the land and land rights account of \$494,159. The entire balance
22 was due to the 2008 purchase of four parcels of land from an affiliated party, EC
23 Development, Inc.

1 **Q. Is there any reason to question the value the Company used to record the land?**

2 A. Yes. Staff has identified multiple reasons to question the recorded value of the land.
3 First, the transaction was not recorded at cost at the time the land was placed in service.
4 Second, the transaction was not at arm's length, and the Company has not shown that the
5 transaction was recorded in accordance with NARUC audit guidelines for affiliate
6 transactions. Third, the land appraisal used to value the transaction was conducted by an
7 appraiser that was not independent from the Company. Fourth, the appraisal was flawed.

8
9 **Q. Did the Company record the land in its records on the date that the land was devoted**
10 **to public service?**

11 A. No. The Company recorded the acquisition of four land parcels in its general ledger on
12 October 31, 2008. The Company placed parcels one and four into service in June 2003,
13 parcel two in 2004 and parcel three in 2007. Thus, each of the four parcels was placed
14 into service between one and five years prior to the recorded in-service date. Plant should
15 be recorded at cost at the time it is devoted to public service.

16
17 **Q. What caused the Company to delay recording the land until long after it was placed**
18 **into service?**

19 A. In response to Staff data request GTM-7.9, the Company stated that it was an inadvertent
20 oversight by the Company at that point of time.

21
22 **Q. What is the relationship between the Company and the land seller?**

23 A. Goodman purchased the four parcels of real estate from EC Development for \$490,000.
24 EC Development is owned by Alex Sears and James Shiner. In response to Staff data
25 request GTM-1.11, the Company identified Mr. Sears and Mr. Shiner, among others, as
26 affiliates of the Company. My Sears and Mr. Shiner are both owners of Goodman as well.

1 **Q. What is the concern regarding non-arm's length transactions?**

2 A. Non-arm's length transactions are suspect of self-dealing and may not be conducted at
3 market price. The purchaser of the land, in this case, is related to the seller of the land. In
4 such cases, it is not clear whether the price paid for the real estate was truly market value.

5
6 **Q. According to NARUC audit guidelines, what is an appropriate basis for recording**
7 **the transfer of a capital asset from an affiliate to a utility?**

8 A. Generally, the transfer of assets from an affiliate to the utility should be at the lower of
9 prevailing market price or net book value, and an appraisal should be used to determine
10 the market price.

11
12 **Q. Has the Company shown that the transaction for the land was recorded in**
13 **accordance with NARUC audit guidelines for affiliate transactions?**

14 A. No. The Company has not provided the book value of the land carried by the seller.

15
16 **Q. What did the Company use to determine the basis for the amount to record the land?**

17 A. The Company recorded the land's acquisition price based on a Summary Appraisal Report
18 performed by Michael Naifeh, MAI, CRE, dated June 26, 2008.

19
20 **Q. Is the appraiser independent of the parties to the transaction?**

21 A. No. The appraiser properly discloses in his appraisal that he has a financial interest
22 related indirectly to the transaction.

23
24 **Q. What is the appraiser's relation to the transaction?**

25 A. In response to GTM-7.7, the appraiser has an investment in a company which has an
26 investment in another company owned by one of Goodman's principals.

1 **Q. What is the appraiser's financial interest in the transaction?**

2 A. In response to GTM-7.8, the Company stated that the appraiser has an approximate two
3 percent interest in D&D Investments West which is owned by Alexander Sears.

4
5 **Q. Is the appraiser's financial interest in the transaction relevant?**

6 A. Yes. An appraiser's evaluation of a property's value should be an independent market-
7 based assessment. In this case, the appraiser's financial interest in the underlying
8 participants creates a potential conflict of interest. There are both appraisal guidelines and
9 Federal Deposit Insurance Corporation regulations that require that an appraiser have no
10 interest, financial or otherwise, in the property or the transaction. The appraiser's proper
11 disclosure of a financial interest does not resolve the conflict of interest caused by the lack
12 of independence; accordingly, the appraisal's reliability is called into question.

13
14 **Q. How does Staff recommend that the land be valued?**

15 A. Since the seller's book value of the property is unknown and Company's appraised value
16 is suspect, Staff recommends using the 2009 Pinal County Assessor's Full Cash Value
17 ("FCV") for the four parcels.

18
19 **Q. Why is Staff using the Pinal County Assessor's 2009 FCV?**

20 A. Because, unfortunately, it is the best information available. Staff would prefer to use data
21 from 2003 or 2004, when the majority of the parcels were placed into service; however,
22 those numbers are not available. Accordingly, Staff used the earliest date for which FCV
23 is available for all four parcels. Had Staff used the assessor's current year (2011) FCV,
24 the value of the four parcels would have fallen to \$66,500.

25

1 **Q. What is Staff recommending?**

2 A. Staff recommends a \$369,500 reduction in the land's basis to \$124,659, as shown in
3 GTM-5.

4

5 **Rate Base Adjustment No. 2 – Reclassify Water Treatment Plant**

6 **Q. What did the Company propose with respect to water treatment equipment?**

7 A. Goodman proposed a balance of \$15,947 in account number 320, Water Treatment Plant.

8

9 **Q. Is general account number 320 normally divided into subaccounts?**

10 A. Yes. Normally, account number 320 is divided into subaccounts. Since there is a
11 significant difference in the expected lives of various water treatment equipment, it is
12 appropriate to establish subaccounts, each with its own depreciation rate.

13

14 **Q. What does Staff recommend with respect to the Water Treatment Equipment?**

15 A. Based on the Company's response to GTM-1.5, Staff recommends reclassifying \$15,947
16 to G/L account 320.2, Chemical Solution Feeders, as shown in Schedule GTM-6.

17

18 **Rate Base Adjustment No. 3 – Reclassify Distribution Reservoirs**

19 **Q. What did the Company propose with respect to distribution reservoirs?**

20 A. Goodman's application proposes \$836,890 in G/L account number 330, Distribution
21 Reservoirs and Standpipe.

22

23 **Q. Is general account number 330 normally divided into subaccounts?**

24 A. Yes. Similar to the discussion above regarding Water Treatment Equipment, normally,
25 account number 330, Distribution Reservoirs, is divided into subaccounts to recognize the
26 various types of equipment and their respective lives, each with its own depreciation rate.

1 **Q. What is Staff recommending?**

2 A. Staff recommends reclassifying the \$836,890 from G/L account number 330, Distribution
3 Reservoirs and Standpipe, to two accounts, \$384,827 going to account 330.1, Storage
4 Tanks, and \$452,063 going to account 330.2, Pressure Tanks, as shown in Schedule GTM-
5 7.

6
7 **Rate Base Adjustment No. 4 – Reduce Storage Tanks**

8 **Q. Did Staff conclude that all of the Company's water storage capacity is necessary for**
9 **the provision of service?**

10 A. No. Staff witness Marlin Scott, Jr. concluded that approximately, one-half of the 530,000
11 gallon storage tank capacity represents excess capacity and recommends a proportional
12 one-half, or \$185,049, disallowance related to the tank cost. Since the excess capacity is
13 not used and useful, it should be removed from rate base. Staff made the \$185,049
14 deduction from the \$384,827 reclassified to account number 330.1, Storage Tanks, as
15 discussed in Staff Rate Base Adjustment No. 3.

16
17 **Q. What is Staff recommending?**

18 A. Staff recommends an \$185,049 negative adjustment to the storage tanks balance, as shown
19 in Schedule GTM-8.

20
21 **Rate Base Adjustment No. 5 – Reduce Transmission and Distribution Mains**

22 **Q. What did the Company propose with respect to transmission and distribution**
23 **mains?**

24 A. In the Company's application, it recorded \$1,611,320 in G/L account 331, Transmission
25 and Distribution Mains.

26

1 **Q. Does Staff have any concerns with the Company's account balance for Transmission**
2 **and Distribution Mains?**

3 A. Yes. Staff witness Marlin Scott, Jr. concluded that a portion of the transmission mains are
4 not used and useful to the Company's ratepayers. A complete discussion of this
5 adjustment may be found in Mr. Scott's direct testimony.

6
7 **Q. What is Staff recommending?**

8 A. Staff recommends a decrease of \$105,564, as shown in Schedule GTM-9, to reflect the
9 portion of plant determined to be not used or useful to the production of water service by
10 the Company.

11
12 **Rate Base Adjustment No. 6 – Reduce Accumulated Depreciation**

13 **Q. What did the Company propose with respect to accumulated depreciation?**

14 A. The Company's application proposed \$731,205 in accumulated depreciation reflecting a
15 \$67,829 pro forma decrease from the end of test year recorded amount of \$799,034.

16
17 **Q. Does Staff concur with the Company's proposal?**

18 A. No. In response to RUCO data request 2.12, the Company acknowledged that it
19 miscalculated the date for implementing newly-authorized depreciation rates resulting
20 from Decision No. 69404. Since that Decision became effective May 1, 2007, the
21 depreciation for 2007 should reflect four months at the previous rates and eight months at
22 the revised rates. Staff recalculated accumulated depreciation for the intervening years to
23 calculate a \$733,602 balance.

24

1 **Q. What is Staff recommending?**

2 A. Staff recommends an increase of \$2,397 to the accumulated depreciation account balance,
3 as shown in Schedule GTM-10.
4

5 **VII. OPERATING INCOME**

6 **REVENUES**

7 **Q. Please summarize the results of Staff's examination of test year operating income.**

8 A. Staff determined a test year operating income of \$87,057, \$13,175 higher than the
9 Company's adjusted test year operating income of \$73,882. Staff's recommendation
10 results from the operating income adjustments described below.
11

12 **Operating Income Adjustment No. 1 – Eliminate Proforma Adjustment for Negative**
13 **Revenue Annualization**

14 **Q. What does the Company propose for operating revenues?**

15 A. The Company has proposed the recorded test year revenues of \$580,110 less a \$7,359 pro
16 forma revenue annualization adjustment for adjusted test year revenues of \$572,751.
17

18 **Q. Is the Company's downward pro forma revenue annualization adjustment consistent**
19 **with other information regarding revenues?**

20 A. No. The Company's revenue annualization adjustment adjusts the billing data for each
21 month of the test year to reflect the end of test year customer count. While this is one of
22 the possible and commonly-used revenue annualization methods, it is not an appropriate
23 method if customer growth is not reasonably linear throughout the year, e.g., when there is
24 seasonal change in customers. The Company's metered water sales increased \$18,356, or
25 3.3 percent, in 2009 over 2008, and metered revenue has continued to increase through
26 2010. This customer growth information indicates that the revenue annualization method

1 proposed by the Company misrepresents the correct revenue trend. Accordingly, the
2 Company's pro forma revenue annualization adjustment should be rejected.

3
4 **Q. What is Staff recommending?**

5 A. Staff recommends the reversal of the Company's proposed \$7,359 negative annualization
6 to test year revenue, as shown in Schedule GTM-13.

7
8 **Operating Income Adjustment No. 2 – Not Used**

9
10 **Operating Income Adjustment No. 3 – Water Testing Expense**

11 **Q. What is the Company proposing for Water Testing Expense?**

12 A. Goodman proposes its actual recorded test year amount of \$1,215 for water testing.

13
14 **Q. Is the Company's actual test year water testing expense representative of its average
15 on-going expense?**

16 A. No. Water testing expense varies from one year to the next based on the schedule
17 intervals for the various tests. Accordingly, water testing expense should be normalized.
18 Staff has determined that the on-going average water testing expense should be \$2,783.

19
20 **Q. What is Staff recommending?**

21 A. Staff recommends Water Testing expense of \$2,783, a \$1,568 increase from the
22 Company's reclassified amount as shown in Schedule GTM-15.

23

Operating Income Adjustment No. 4 – Depreciation Expense

Q. What is the Company proposing for Depreciation expense?

A. The Company proposes its recorded test year depreciation expense of \$228,578 less a \$723 pro forma adjustment for \$227,855.

Q. Did Staff recalculate depreciation expense?

A. Yes. As shown in Schedule GTM-16, Staff recalculated depreciation expense by applying Staff's recommended depreciation rates to Staff's recommended plant by account. Staff calculated depreciation expense of \$228,853, an increase of \$998 from the \$228,853 proposed by the Company.

Q. What is Staff recommending?

A. Staff recommends \$228,853 for Depreciation expense, a \$998 increase from the Company's proposed amount, as shown in Schedule GTM-16.

Operating Income Adjustment No. 5 – Property Tax Expense

Q. What is the Company proposing for test year property tax expense?

A. Goodman proposes \$21,299 for test year property taxes. The proposed amount is \$12,722 greater than the \$8,576 recorded in the test year. The Company calculated its proposed amount using a modified version of the Arizona Department of Revenue's ("ADOR") property tax method.

Q. What method has the Commission typically adopted to determine property tax expense for ratemaking purposes of Class B water utilities?

A. The Commission's practice in recent years has been to use a modified ADOR methodology for water and wastewater utilities.

1 **Q. Using the modified ADOR property tax method, what is the primary factor for**
2 **determining the amount of property tax calculated?**

3 A. The results from the modified ADOR methodology are primarily dependent upon revenue
4 inputs for three years. In the same manner as each operating income has a specific income
5 tax expense, there is a specific property tax expense for each three-year set of revenue
6 inputs. Therefore, the property tax expense calculated for the test year is different than the
7 property tax calculated for the authorized revenue. Only when the revenue inputs for all
8 three years is equal to the test year revenue will the resulting calculation reflect property
9 tax expense that correlates with the test year revenue. Since under the modified ADOR
10 method property tax expense is revenue-dependent in the same manner as is income tax
11 expense, property tax expense must be recalculated to reflect the authorized revenue.
12 Using inputs of one year of authorized revenue and two years of test year revenue in the
13 modified ADOR method provides the average expected property tax over a subsequent
14 three-year period. Use of one year of authorized revenue and two years of test year
15 revenue is consistent with the tax assessment lags used by ADOR.

16
17 **Q. What revenues did the Company use to calculate test year property tax expense?**

18 A. Schedule C-2, page 3, of the Company's application shows that it used one year of
19 proposed revenue and two years of test year revenues to calculate test year property tax
20 expense.

21
22 **Q. Does the Company's property tax calculations reflect an appropriate amount for test**
23 **year property tax expense?**

24 A. No. As discussed above, only when the revenue input for all three years is equal to the
25 test year revenue will the resulting calculation using the modified ADOR method reflect
26 property taxes that correlate with test year revenue. Since the Company included one year

1 of proposed revenue in its calculation, its proposed test year property tax expense reflects
2 the on-going property tax expense, as opposed to test year expense, and will only reflect
3 the on-going expense if the Company's proposed revenue is adopted.

4
5 **Q. Has Staff developed a solution to address the dependent relationship between**
6 **Property Tax expense and revenues?**

7 A. Yes. Staff has included a factor for property taxes in the gross revenue conversion factor
8 ("GRCF") (see Schedule GTM-2) that automatically adjusts the revenue requirement for
9 changes in revenue in the same way that income taxes are adjusted for changes in
10 operating income. This flexible method will accurately reflect property tax expense at any
11 authorized revenue level. This refinement allows for accurate calculation of property tax
12 expense at the test year revenue level, and for recovery of any additional property tax
13 expense incurred due to any increase in authorized revenue. It also removes any necessity
14 to present on-going property tax expense as test year property tax expense. In using the
15 GRCF to calculate the correct revenue requirement, the test year operating income must
16 be determined with property tax expense derived from the modified ADOR method using
17 test year revenue as the input for all three years.

18
19 **Q. What is Staff recommending for test year property tax expense?**

20 A. Staff recommends \$17,301 for test year property tax expense, a \$3,998 reduction from the
21 Company's proposed amount, as shown in Schedule GTM-17.¹ Staff further recommends
22 adoption of its GRCF that includes a factor for property tax expense, as shown in
23 Schedule GTM-2.

24

¹ Schedule GTM-11 also shows calculations for Property Tax Expense for Staff's recommended revenue.

Operating Income Adjustment No. 6 – Income Tax Expense

Q. What is the Company proposing for test year income tax expense?

A. Goodman is proposing \$22,873 for test year income tax expense. The Company's test year income tax expense reflects application of the statutory State and Federal income tax rates to its adjusted test year income.

Q. How did Staff calculate Test Year Income Tax Expense?

A. Staff calculated test year income tax expense of \$18,489 by applying the statutory State and Federal income tax rates to Staff's adjusted test year taxable income, as shown in Schedule GTM-2.

Q. Since Staff and the Company used the same tax rates and methods to calculate test year income tax expense, what accounts for the difference between the Staff and the Company test year income tax expenses?

A. Staff and the Company used different test year operating expenses and synchronized interest to calculate taxable income.

Q. What is Staff recommending?

A. Staff recommends test year income tax expense of \$18,489, as shown in Schedule GTM-2 and GTM-18.

Q. Does Staff have any additional comments regarding income taxes?

A. Yes. On Schedule C-3, the Company shows its calculation of a 1.6254 gross revenue conversion factor. Schedule GTM-2 shows the calculation of Staff's 1.7381 GRCF. This difference in GRCF is due to the Company's use of a lower average Federal tax rate (31.5

1 percent) than Staff (37.5 percent) and to a lesser extent Staff's inclusion of a factor for
2 property tax expense.

3
4 Staff Schedule GTM-2 provides a reconciliation of Staff's test year and recommended
5 revenues. The reconciliation shows the incremental operating income, property tax
6 expense and income tax expense components of Staff recommended increase in revenue.
7 The reconciliation verifies that Staff's 1.7381 GRCF results in the recommended
8 operating income.

9
10 **VIII. AFFILIATED TRANSACTIONS**

11 **Q. Are there any affiliated parties involved in this rate case?**

12 A. Yes. In response to GTM-1.11 the Company identified Alexander Sears, Jim Shiner, EC
13 Development, and Goodman Ranch Associates as related parties.

14
15 **Q. Does Goodman have any written affiliated transaction policies?**

16 A. No. In response to Staff data request GTM-1.12, the Company stated that it had no
17 affiliated transaction policies.

18
19 **Q. Why is Staff concerned with affiliated transactions?**

20 A. When related parties choose to enter into a business (non-arm's length) transaction, there
21 is usually reason to question whether a true market price for the good or service
22 exchanged was obtained.

23

1 **Q. Did Staff find any instances of non-arm's length transactions?**

2 A. Yes. As discussed above regarding rate base adjustment no. 1, Goodman's purchase of
3 four land parcels from EC Development, which is owned by Mr. Sears and Mr. Shiner, is
4 a non-arm's length transaction.

5
6 **Q. Are there other examples of affiliated transactions?**

7 A. Yes. During the test year Goodman employed Jim Shiner to provide management
8 services.

9
10 **Q. Does Mr. Shiner have a written employment agreement with the Company?**

11 A. According to the Company's response to Staff data request GTM-4.8, no such agreement
12 exists.

13
14 **Q. Why is the Company's selection Mr. Shiner as an outside contractor a concern?**

15 A. As noted above, Mr. Shiner is an affiliated party. Part of his job responsibilities,
16 according to the Company's response to Staff data request GTM-1.6, is to hire contractors
17 and supervise service contractors, of which he is one.

18
19 **Q. Does the Company have written policies regarding the hiring of outside contractors?**

20 A. No. According to the Company's response to Staff data request GTM-7.11, the Company
21 has not formulated policies in this area due to its small size.

22
23 **Q. Does the Company utilize a formal competitive bidding process with respect to the**
24 **hiring of outside contractors?**

25 A. No. According to the Company's response to Staff data request GTM-7.13, the Company
26 does not use a formal competitive bidding process in the selection of outside contractors.

1 **Q. Has Staff identified another example of affiliated transactions?**

2 A. Yes. In February 2008, the Company borrowed \$527,400 from its affiliated parent (EC
3 Development).

4
5 **Q. Was this financing authorized?**

6 A. Yes. The authority to incur debt was authorized by ACC Decision No. 56118, dated
7 September 15, 1988.

8
9 **Q. Why was there a twenty-year delay between the financing authorization and its**
10 **execution?**

11 A. According to the Company's response to Staff data request GTM-4.12, the Company 1)
12 did not have the need for debt-funded growth and 2) did not have sufficient financial
13 capacity to support long term debt until the new rates went into effect in May 2007
14 (Commission Decision No. 69404).

15
16 **Q. Does the twenty-year delay concern Staff?**

17 A. Yes. Financial conditions of an organization can change drastically over a twenty year
18 period. In recent years, the Commission has typically established expiration dates on
19 finance authorizations to mitigate the concern regarding changing financial conditions of
20 utilities.

21
22 **Q. What does Staff recommend?**

23 A. Staff recommends that the Company develop and implement written policies pertaining to
24 affiliated transactions and hiring of outside consultants.

25

IX. RATE DESIGN

Present Rate Design

Q. Please provide an overview of the Company's present rates.

A. The following is a general description of the present rate structure. Details of the rate designs are presented in Schedule GTM-19. The present rate structure includes residential, commercial, and construction customer classes. The present rate structure for the residential, commercial, and construction customer classes consists of an inverted three-tier commodity rate for 5/8 x 3/4-inch and 3/4-inch meters. An inverted two-tier commodity rate structure applies to larger meters. A minimum monthly fixed charge that increases by meter size is also applicable to residential and commercial customers.

Company's Proposed Water Rate Design

Q. Please provide an overview of the Company's proposed rate structure.

A. The Company proposes a rate structure similar to the present rate structure that collects a greater proportion of the revenue from the commodity rates and spreads the rates between the tiers by a greater ratio by increasing the ratio between the first and second tiers for 5/8 x 3/4-inch and 3/4-inch meters. On average, the Company's proposed rates increase by 50.24 percent to achieve its proposed revenue requirement.

Q. Did the Company propose to change the amount for any of its existing water system service charges?

A. No. The Company proposes to maintain the currently-authorized amounts for existing service charges; however, it is proposing two new types of service charges. The Company's proposed service charges are shown in the Company's Schedule H-3 and Staff Schedule GTM-19.

1 **Q. Has the Company submitted proposed tariff language specifying the terms and**
2 **conditions as well as its rates and charges?**

3 **A. No. The Company's application proposes only rates and charges. No specific tariff**
4 **language is proposed.**

5
6 **Q. What are the two new service charge tariffs the Company proposes?**

7 **A. The Company proposes a turn-on/off charge and a moving service meter charge.**
8

9 **Q. How does the Company propose to apply the \$75.00 turn on/off tariff?**

10 **A. In response to GTM-8.1, the Company stated that this tariff would apply when a customer**
11 **originates a request to turn on/off water services in the non-establishment or non-**
12 **reconnection of water service situations.**

13
14 **Staff's Recommended Water Rate Design**

15 **Q. Please provide a description of Staff's recommended rate structure for the water**
16 **system.**

17 **A. Staff also recommends continuation of the fundamental existing rate structure. However,**
18 **Staff recommends spreading the rates between the tiers by an even greater ratio than**
19 **proposed by the Company and generating an even greater percentage of the revenue from**
20 **the commodity rates. Staff recommends the following monthly fixed charges by customer**
21 **class: 5/8 x 3/4-inch meter, \$47.50; 3/4-inch meter, \$71.30; 1-inch meter, \$119.00; 1.5-**
22 **inch meter, \$238.00; 2-inch meter, \$380.00; 3-inch meter, \$760.00; 4-inch meter,**
23 **\$1,188.00; and 6-inch meter, \$2,375.00. Staff recommends the following commodity**
24 **rates per 1,000 gallons of water use by the 5/8 x 3/4-inch residential class, 1 to 3,000**
25 **gallons, \$4.50 per 1,000 gallons; 3,001 to 9,000 gallons, \$9.00 per 1,000 gallons; and over**
26 **9,000 gallons, \$11.00 per 1,000 gallons.**

1 **Q. Did Staff prepare schedules showing the present, Company proposed, and Staff**
2 **recommended monthly minimums and commodity rates for each rate class?**

3 A. Yes. Staff's Direct Testimony Schedule GTM-19 shows the present monthly fixed
4 charges and commodity rates, the Company's proposed monthly fixed charges and
5 commodity rates and Staff's recommended monthly fixed charges and commodity rates.

6
7 **Q. Did Staff prepare a schedule showing the average and median monthly bill under**
8 **present rates, the Company's proposed rates, and Staff's recommended rates?**

9 A. Yes. Staff's Direct Testimony Schedule GTM-20 presents the typical bill analysis for a
10 residential water customer using present rates, the Company's proposed rates and Staff's
11 recommended rates.

12
13 **Q. What is the impact to the median customer bill with Staff's rate design?**

14 A. The typical bill for a residential customer would increase by \$13.55, or 22.22 percent,
15 from \$60.96 to \$74.50.

16
17 **Q. Does Staff have any comment pertaining to the Company's proposal to initiate a**
18 **\$75.00 turn on/off tariff?**

19 A. Yes. Staff does not see the necessity of a separate charge addressing specifically the need
20 for turning on/off water at the customer's request. For the most part, customers already
21 have the ability to shut off their own water. In fact, Arizona Administrative Code R14-2-
22 405(B)(3) requires that for new service the customer will provide and maintain a private
23 cutoff valve within 18 inches of the meter on the customer's side of the meter. Staff
24 concludes that enforcement of the existing rule is a better solution than creating a new
25 tariff. Staff further notes that such a tariff is not common among other water utilities,

1 which typically provide water cutoff during normal working hours as a courtesy service,
2 without an additional charge.
3

4 **Q. What does Staff recommend?**

5 A. Staff recommends denial of the turn on/off charge.
6

7 **Q. Does Staff have any comment pertaining to the Company's proposal to initiate a**
8 **moving service meter tariff?**

9 A. Staff agrees with the Company's proposal to charge the customer at cost to move the
10 meter at the customer's request. Such charges were anticipated and are permissible in
11 accordance with Arizona Administrative Code R14-2-405(B)(5).
12

13 **Q. What is Staff's position on after-hours service charges?**

14 A. Staff agrees with the Company that an after-hour service charge is appropriate when it is
15 at the customer's request/convenience. Such a tariff compensates the utility for additional
16 expenses incurred from providing after-hours service. Staff notes, however, that, in
17 addition to its \$10.00 after-hours service charge, the Company has a separate tariff for
18 establishment after-hours that *includes* a \$25 premium over the charge for establishment
19 during regular hours. Further, the Company has a separate tariff for reconnection after-
20 hours that provides for a \$50 premium *in addition to* the reconnection charge during
21 regular hours. Although the Company intent is not to apply more than one after-hours
22 charge, such inconsistent tariffs are not only confusing, but create the potential for
23 duplication of charges for the same service.
24

25 **Q. What does Staff recommend?**

26 A. Staff recommends the elimination of both the \$75 establishment (after hours) tariff and the
27 \$50.00 reconnection (after-hours) tariff. Staff further recommends that the after-hours

1 service charge be increased to \$50 and that this fee be in addition to the charge for any
2 utility service provided after hours at the customer's request or for the customer's
3 convenience. For example, under Staff's proposal, a customer would be subject to a \$50
4 establishment fee if it is done during normal business hours, but would pay an additional
5 \$50 after-hours fee if the customer requested that the establishment be done after normal
6 working hours.
7

8 **Q. Does Staff have any other tariff recommendations?**

9 A. Staff recommends that the Company be required to produce written language in each tariff
10 explaining the terms and conditions for each of the rates and charges.
11

12 **Q. What water system service charges does Staff recommend?**

13 A. Staff's recommendations for service charges are shown in Schedule GTM-19. These
14 service charges will generate \$13,738 based on the Company's estimates for the various
15 services provided in the test year as previously discussed.
16

17 **Q. Will Staff's recommended rate design generate Staff's recommended revenue
18 requirement?**

19 A. Staff's recommended rate design would generate Staff's recommended water revenue
20 requirement of \$700,939, composed of \$687,201 from water sales and \$13,738 from other
21 revenues.
22

23 **Q. Does this conclude your Direct Testimony?**

24 A. Yes, it does.

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

DIRECT TESTIMONY - GARY T. McMURRY

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REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY FAIR VALUE	(C) STAFF ORIGINAL COST	(D) STAFF FAIR VALUE
1	Adjusted Rate Base	\$ 2,402,222	\$ 2,402,222	\$ 1,739,712	\$ 1,739,712
2	Adjusted Operating Income (Loss)	\$ 73,882	\$ 73,882	\$ 87,057	\$ 87,057
3	Current Rate of Return (L2 / L1)	3.08%	3.08%	5.00%	5.00%
4	Required Rate of Return	10.54%	10.54%	9.00%	9.00%
5	Required Operating Income (L4 * L1)	\$ 253,194	\$ 253,194	\$ 156,574	\$ 156,574
6	Operating Income Deficiency (L5 - L2)	\$ 179,312	\$ 179,312	\$ 69,517	\$ 69,517
7	Gross Revenue Conversion Factor	1.6254	1.6254	1.7381	1.7381
8	Required Revenue Increase (L7 * L6)	\$ 291,454	\$ 291,454	\$ 120,829	\$ 120,829
9	Adjusted Test Year Revenue	\$ 572,751	\$ 572,751	\$ 580,110	\$ 580,110
10	Proposed Annual Revenue (L8 + L9)	\$ 864,205	\$ 864,205	\$ 700,939	\$ 700,939
11	Required Increase in Revenue (%)	50.89%	50.89%	20.83%	20.83%
12	Rate of Return on Common Equity (%)	11.00%	11.00%	9.10%	9.10%

References:

Column (A): Company Schedule B-1
Column (B): Company Schedule B-1
Column (C): Company Schedules A-1, A-2, & D-1
Column (D): Staff Schedule GTM-2 , GTM-3 & GTM-11
Column (E): Staff Schedule GTM-2 , GTM-3 & GTM-11
Column (F): Staff Schedule GTM-2 , GTM-3 & GTM-11

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.0000%			
3	Revenues (L1 - L2)	100.0000%			
4	Combined Federal and State Tax Rate (Line 17) + Property Tax Factor (Line 23)	42.4668%			
5	Subtotal (L3 - L4)	57.5332%			
6	Revenue Conversion Factor (L1 / L5)	1.7381			
<u>Calculation of Uncollectible Factor:</u>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	41.8891%			
9	One Minus Combined Income Tax Rate (L7 - L8)	58.1109%			
10	Uncollectible Rate	0.0000%			
11	Uncollectible Factor (L9 * L10)	0			
<u>Calculation of Effective Tax Rate:</u>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	6.9680%			
14	Federal Taxable Income (L12 - L13)	93.0320%			
15	Applicable Federal Income Tax Rate (Line 53)	37.5367%			
16	Effective Federal Income Tax Rate (L14 x L15)	0.349211069			
17	Combined Federal and State Income Tax Rate (L13 + L16)	41.8891%			
<u>Calculation of Effective Property Tax Factor</u>					
18	Unity	100.0000%			
19	Combined Federal and State Tax Rate (Line 17)	41.8891%			
20	One Minus Combined Income Tax Rate (L18 - L19)	58.1109%			
21	Property Tax Factor (GTM-18, L24)	0.9941%			
22	Effective Property Tax Factor (L21 * L22)	0.5777%			
23	Combined Federal and State Tax and Property Tax Rate (L17+L22)		42.4668%		
24	Required Operating Income (Schedule GTM-1, Line 5)	\$ 156,574			
25	Adjusted Test Year Operating Income (Loss) (Schedule GTM-10, Line 40)	\$ 87,057			
26	Required Increase in Operating Income (L24 - L25)		\$ 69,517		
27	Income Taxes on Recommended Revenue (Col. (D), L52)	\$ 68,600			
28	Income Taxes on Test Year Revenue (Col. (B), L52)	\$ 18,489			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		\$ 50,111		
30	Recommended Revenue Requirement (Schedule GTM-1, Line 10)	\$ 700,939			
31	Uncollectible Rate (Line 10)	0.0000%			
32	Uncollectible Expense on Recommended Revenue (L24 * L25)	\$ -			
33	Adjusted Test Year Uncollectible Expense	\$ -			
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32 - L33)		\$ -		
35	Property Tax with Recommended Revenue (GTM-18, L19)	\$ 18,502			
36	Property Tax on Test Year Revenue (GTM-17, L16)	\$ 17,301			
37	Increase in Property Tax Due to Increase in Revenue (GTM-17, L22)		\$ 1,201		
38	Total Required Increase in Revenue (L26 + L30 + L34+L37)		\$ 120,829		
<u>Calculation of Income Tax:</u>					
		Test Year		STAFF Recommended	
39	Revenue (Schedule GTM-10, Col.[C], Line 5 & Sch. GTM-1, Col. [B], Line 10)	\$ 580,110		\$ 700,939	
40	Operating Expenses Excluding Income Taxes	\$ 474,564		\$ 475,765	
41	Synchronized Interest (L56)	\$ 27,835		\$ 27,835	
42	Arizona Taxable Income (L39 - L40- L41)	\$ 77,711		\$ 197,339	
43	Arizona State Income Tax Rate	6.9680%		6.9680%	
44	Arizona Income Tax (L42 x L43)		\$ 5,415		\$ 13,751
45	Federal Taxable Income (L42 - L44)	\$ 72,296		\$ 183,588	
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ 7,500		\$ 7,500	
47	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	\$ 5,574		\$ 6,250	
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -		\$ 8,500	
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -		\$ 32,599	
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -		\$ -	
51	Total Federal Income Tax		\$ 13,074		\$ 54,849
52	Combined Federal and State Income Tax (L35 + L42)		\$ 18,489		\$ 68,600
53	Applicable Federal Income Tax Rate [Col. (D), L42 - Col. (B), L42] / [Col. (C), L36 - Col. (A), L36]				37.54%
<u>Calculation of Interest Synchronization:</u>					
54	Rate Base (Schedule GTM-3, Col. [C], Line (17))	\$ 1,739,712			
55	Weighted Average Cost of Debt (Schedule GTM-1)	1.60%			
56	Synchronized Interest (L45 X L46)	\$ 27,835			

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	REF	(C) STAFF AS ADJUSTED
1	Plant in Service	\$ 5,453,761	\$ (660,113)	\$ 4,793,648
2	Less: Accumulated Depreciation	731,205	2,397	733,602
3	Net Plant in Service	<u>\$ 4,722,556</u>	<u>\$ (662,510)</u>	<u>\$ 4,060,046</u>
<u>LESS:</u>				
4	Contributions in Aid of Construction (CIAC)	\$ -	\$ -	\$ -
5	Less: Accumulated Amortization	-	-	-
6	Net CIAC	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
7	Advances in Aid of Construction (AIAC)	2,101,905	-	2,101,905
8	Service Line & Meter Installation Charges	83,087	-	83,087
9	Deferred Income Tax Credits	135,342	-	135,342
<u>ADD:</u>				
10	Unamortized Finance Charges	-	-	-
11	Deferred Tax Assets	-	-	-
12	Working Capital	-	-	-
13	Intentionally Left Blank	-	-	-
14	Original Cost Rate Base	<u>\$ 2,402,222</u>	<u>\$ (662,510)</u>	<u>\$ 1,739,712</u>

References:

Column (A), Company Schedule B-1
Column [B]: Column [C] - Column [A]
Column [C], GTM-4

GOODMAN WATER COMPANY
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Test Year ended December 31, 2009

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	ACCT. NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) LAND ADJ.#1	(C) WATER TREATMENT ADJ.#2	(D) DISTRIBUTION RESERVOIR ADJ.#3	(E) DISTRIBUTION RESERVOIR ADJ.#4	(F) TRANSMISSION MAINS ADJ.#5	(G) ACCUMULATED DEPRECIATION ADJ.#6	(H) STAFF ADJUSTED
PLANT IN SERVICE:										
1	301	Organization Cost	\$ 127,103	-	-	-	-	-	-	\$ 127,103
2	302	Franchise Cost	-	-	-	-	-	-	-	-
3	303	Land and Land Rights	494,159	(369,500)	-	-	-	-	-	124,659
4	304	Structures and Improvements	182,570	-	-	-	-	-	-	182,570
5	305	Collecting and Impounding Res.	-	-	-	-	-	-	-	-
6	306	Lake River and other Intakes	-	-	-	-	-	-	-	-
7	307	Wells and Springs	386,591	-	-	-	-	-	-	386,591
8	308	Infiltration Galleries and Tunnels	-	-	-	-	-	-	-	-
9	309	Supply Mains	-	-	-	-	-	-	-	-
10	310	Power Generation Equipment	968,652	-	-	-	-	-	-	968,652
11	311	Electrical Pumping Equipment	15,947	-	(15,947)	-	-	-	-	-
12	320	Water Treatment Equipment	-	-	-	-	-	-	-	-
13	320.1	Water Treatment Plant	-	-	15,947	-	-	-	-	15,947
14	320.2	Chemical Solution Feeders	-	-	-	-	-	-	-	-
15	330	Distribution Reservoirs & Standpipe	-	-	-	-	-	-	-	-
16	330.1	Storage Tanks	836,890	-	-	(836,890)	-	-	-	-
17	330.2	Pressure Tanks	-	-	-	384,827	-	-	-	384,827
18	331	Transmission and Distribution Mains	1,611,320	-	-	452,063	(185,049)	(105,564)	-	199,778
19	333	Services	386,947	-	-	-	-	-	-	452,063
20	334	Meters	94,263	-	-	-	-	-	-	1,505,756
21	335	Hydrants	161,737	-	-	-	-	-	-	386,947
22	336	Backflow Prevention Devices	-	-	-	-	-	-	-	94,263
23	339	Other Plant & Miscellaneous Equipment	187,582	-	-	-	-	-	-	161,737
24	340	Office Furniture & Fixtures	-	-	-	-	-	-	-	-
25	340.1	Computers & Software	-	-	-	-	-	-	-	-
26	341	Transportation Equipment	-	-	-	-	-	-	-	-
27	342	Stores Equipment	-	-	-	-	-	-	-	-
28	343	Tools and Work Equipment	-	-	-	-	-	-	-	-
29	344	Laboratory Equipment	-	-	-	-	-	-	-	-
30	345	Power Operated Equipment	-	-	-	-	-	-	-	-
31	346	Communications Equipment	-	-	-	-	-	-	-	-
32	347	Miscellaneous Equipment	-	-	-	-	-	-	-	-
33	348	Other Tangible Plant	-	-	-	-	-	-	-	-
34		Rounding Amount	\$ 5,453,761	\$ (369,500)	\$ -	\$ -	\$ (185,049)	\$ (105,564)	\$ -	\$ 4,793,648
35		Subtotal Plant in Service								
36		Add:								
37	Other 1	Intentionally Left Blank	-	-	-	-	-	-	-	-
38	Other 2	Intentionally Left Blank	-	-	-	-	-	-	-	-
39	Less:									
40	Other 3	Intentionally Left Blank	-	-	-	-	-	-	-	-
41	Other 4	Intentionally Left Blank	-	-	-	-	-	-	-	-
42		Total Plant in Service:	\$ 5,453,761	\$ (369,500)	\$ -	\$ -	\$ (185,049)	\$ (105,564)	\$ -	\$ 4,793,648
43		Less: Accumulated Depreciation	731,205	-	-	-	-	-	2,397	733,602
44		Intentionally Left Blank	-	-	-	-	-	-	-	-
45		Net Plant in Service (L59 - L 60)	\$ 4,722,556	\$ (369,500)	\$ -	\$ -	\$ (185,049)	\$ (105,564)	\$ (2,397)	\$ 4,060,046
46										
47		LESS:								
48		Contributions in Aid of Construction (CIAC)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
49		Less: Accumulated Amortization	-	-	-	-	-	-	-	-
50		Net CIAC (L49 - L50)	-	-	-	-	-	-	-	-
51		Advances in Aid of Construction (AIAC)	2,101,905	-	-	-	-	-	-	2,101,905
52		Service Line & Meter Installation Charges	83,087	-	-	-	-	-	-	83,087
53		Deferred Income Taxes	135,342	-	-	-	-	-	-	135,342
54										
55		ADD:								
56		Unamortized Finance Charges	-	-	-	-	-	-	-	-
57		Deferred Tax Assets	-	-	-	-	-	-	-	-
58		Working Capital	-	-	-	-	-	-	-	-
59		Regulatory Asset (Liability)	-	-	-	-	-	-	-	-
60		Original Cost Rate Base	\$ 2,402,222	\$ (369,500)	\$ -	\$ -	\$ (185,049)	\$ (105,564)	\$ (2,397)	\$ 1,739,712
61										

References:
Column [A] Schedule B-2, E-1

ORIGINAL COST RATE BASE ADJUSTMENT # 1 - REDUCE COST BASIS FOR LAND PURCHASE

Line No.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	303	Land and Land Rights	\$ 494,159	\$ (369,500)	\$ 124,659

	Accessor's Parcel No.	Acres	Full Cash Value 2009 ¹	Market Value Opinion ²
2				
3	1 305-93-219 A	0.09	\$ 40,000	\$ 180,000 ³
5	2 305-31-013 Q	0.25	40,000	60,000
6	3 305-93-219 B	0.39	40,000	100,000
7	4 305-93-604 O	0.63	500	150,000
8				
9		1.3564	\$ 120,500	\$ 490,000

- (1) - This is the full cash value (FCV) for 2009 as obtained from the Pinal County Assessor's website.
(2) - The Company provided a six page "A Summary Appraisal Report developing market value opinions of the underlying land (a fractional interest appraisal)" by M. Naifeh, MAI, CRE.
(3) - Parcel "one" is comprised of two real estate parcels.

Staff's basis for Land

Assesor's FCV	\$ 120,500
Closing Costs	2,159
Appraisal Fee	2,000
	<u>\$ 124,659</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM Testimony
Col [C]: Col. [A] + Col. [B]
Col [C]: Col. [A] + Col. [B]

GOODMAN WATER COMPANY

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Schedule GTM-6

ORIGINAL COST RATE BASE ADJUSTMENT # 2 - RECLASSIFY WATER TREATMENT EQUIPMENT

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	320	Water Treatment Equipment	\$ 15,947	\$ (15,947)	\$ -
2	320.1	Water Treatment Plant		-	-
3	320.2	Chemical Solution Feeders		\$ 15,947	\$ 15,947
4		Total	<u>\$ 15,947</u>	<u>\$ -</u>	<u>\$ 15,947</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GTM Testimony , SDR GTM-1.5

Col [C]: Col. [A] + Col. [B]

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Schedule GTM-7

ORIGINAL COST RATE BASE ADJUSTMENT # 3 - RECLASSIFY DISTRIBUTION RESERVOIRS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	330	Distribution Reservoirs & Standpipe	\$ 836,890	\$ (836,890)	\$ -
2	330.1	Storage Tanks		\$ 384,827	\$ 384,827
3	330.2	Pressure Tanks		\$ 452,063	\$ 452,063
4		Total	<u>\$ 836,890</u>	<u>\$ -</u>	<u>\$ 836,890</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM Testimony, SDR GTM-1.4
Col [C]: Col. [A] + Col. [B]

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Schedule GTM-8

ORIGINAL COST RATE BASE ADJUSTMENT # 4 - ELIMINATE EXCESS CAPACITY - STORAGE TANK

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	331	Storage Tanks ¹	<u>\$ 384,827</u>	<u>\$ (185,049)</u>	<u>\$ 199,778</u>

¹ The Company proposed amount is the portion claimed by the Company and reclassified by Staff to Acct. 330.1 as shown in GTM-7.

References:

Col [A]: Company Schedule B-1

Col [B]: GTM and MSJ Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GTM-9

ORIGINAL COST RATE BASE ADJUSTMENT # 5 - ELIMINATE EXCESS CAPACITY - DISTRIBUTION MAINS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	333	Transmission and Distribution Mains	<u>1,611,320</u>	<u>\$ (105,564)</u>	<u>\$ 1,505,756</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

ORIGINAL COST RATE BASE ADJUSTMENT # 6 - ADJUST ACCUMULATED DEPRECIATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Depreciation	\$ 731,205	\$ 2,397	\$ 733,602
			Accumulated Depreciation per application	Accumulated Depreciation per Staff	Difference
2		Structures and Improvements	\$ 10,285	\$ 10,289	\$ 4
3		Collecting and Impounding Res.	-	-	-
4		Lake River and other Intakes	-	-	-
5		Wells and Springs	67,423	67,557	134
6		Infiltration Galleries and Tunnels	-	-	-
7		Supply Mains	-	-	-
8		Power Generation Equipment	-	-	-
9		Electrical Pumping Equipment	341,101	343,970	2,869
10		Water Treatment Equipment	2,167	2,172	5
11		Water Treatment Plant	-	-	-
12		Chemical Solution Feeders	-	-	-
13		Distribution Reservoirs & Standpipe	64,318	-	(64,318)
14		Storage Tanks	-	51,229	51,229
15		Pressure Tanks	-	15,136	15,136
16		Transmission and Distribution Mains	139,059	135,664	(3,395)
17		Services	40,947	41,022	75
18		Meters	17,066	17,456	390
19		Hydrants	12,984	12,962	(22)
20		Backflow Prevention Devices	-	-	-
21		Other Plant & Miscellaneous Equipment	35,847	36,136	289
22		Office Furniture & Fixtures	-	-	-
23		Computers & Software	-	-	-
24		Transportation Equipment	-	-	-
25		Stores Equipment	-	-	-
26		Tools and Work Equipment	-	-	-
27		Laboratory Equipment	-	-	-
28		Power Operated Equipment	-	-	-
29		Communications Equipment	-	-	-
30		Miscellaneous Equipment	-	-	-
31		Other Tangible Plant	-	-	-
			\$ 731,197	\$ 733,594	\$ 2,397

References:

Col [A]: Company Schedule B-1
Col [B]: GTM Testimony, RUCO DR 2.12
Col [C]: Col. [A] + Col. [B]

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

LINE NO.	DESCRIPTION	[A] COMPANY ADJUSTED TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
1	<u>OPERATING REVENUES:</u>					
2	Metered Water Revenues	\$ 559,013	\$ 7,359	\$ 566,372	\$ 120,829	\$ 687,201
3	Unmetered Water Revenues	-	-	-	-	-
4	Other Water Revenues	13,738	-	13,738	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 7,359	\$ 580,110	\$ 120,829	\$ 700,939
6						
7	<u>OPERATING EXPENSES:</u>					
8	Salaries and Wages	\$ 40,000	-	\$ 40,000	\$ -	\$ 40,000
9	Employee Pensions & Benefits	-	-	-	-	-
10	Purchased Water	-	-	-	-	-
11	Purchased Power	27,066	-	27,066	-	27,066
12	Chemicals	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	7,746	-	7,746
14	Office Supplies and Expense	14,855	-	14,855	-	14,855
15	Outside Services	102,925	-	102,925	-	102,925
16	Water Testing	1,215	1,568	2,783	-	2,783
17	Rents	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-
19	Insurance - General Liability	9,669	-	9,669	-	9,669
20	Insurance - Health and Life	-	-	-	-	-
21	Advertising	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	-	20,000	-	20,000
23	Regulatory Comm Expense - Other	378	-	378	-	378
24	Bad Debt Expense	-	-	-	-	-
25	Miscellaneous Expense	-	-	-	-	-
26	Depreciation and Amortization	227,855	998	228,853	-	228,853
27	Interest on Security Deposits	-	-	-	-	-
28	Taxes other than Income	2,988	-	2,988	-	2,988
29	Property Taxes	21,299	(3,998)	17,301	1,201	18,502
30	Income Tax	22,873	(4,384)	18,489	50,111	68,600
31	Total Operating Expenses	\$ 498,869	\$ (5,816)	\$ 493,053	\$ 51,312	\$ 544,365
32						
33	Operating Income	\$ 73,882	\$ 13,175	\$ 87,057	\$ 69,517	\$ 156,574

References:

Column [A]: Company Schedule C-1
Column [B]: Schedule GTM-11
Column [C]: Column [A] + Column [B]
Column [D]: Schedules GTM-1 and GTM-2
Column [E]: Column [C] + Column [D]

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] GTM-13 Revenue Annualization ADJ #1	[C] GTM-14 Not Used ADJ #2	[D] GTM-15 Water Testing ADJ #3	[E] GTM-16 Depreciation Exp ADJ #4	[F] GTM-17 Property Taxes ADJ #5	[G] GTM-18 Income Taxes ADJ #6	[H] STAFF ADJUSTED
1	Operating Revenues:								
2	Metered Water Revenues	\$ 559,013	\$ 7,359	-	-	-	-	-	\$ 566,372
3	Unmetered Water Revenues	13,738	-	-	-	-	-	-	13,738
4	Other Water Revenues	-	-	-	-	-	-	-	-
5	Total Operating Revenues	\$ 572,751	\$ 7,359	-	-	-	-	-	\$ 580,110
6									
7	Operating Expenses:								
8	Salaries and Wages	\$ 40,000	-	-	-	-	-	-	40,000
9	Employee Pensions & Benefits	-	-	-	-	-	-	-	-
10	Purchased Water	-	-	-	-	-	-	-	27,066
11	Purchased Power	27,066	-	-	-	-	-	-	-
12	Chemicals	-	-	-	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	-	-	-	-	-	7,746
14	Office Supplies and Expense	14,855	-	-	-	-	-	-	14,855
15	Outside Services	102,925	-	-	-	-	-	-	102,925
16	Water Testing	1,215	-	-	1,568	-	-	-	2,783
17	Rents	-	-	-	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-	-	-	-
19	Insurance - General Liability	9,669	-	-	-	-	-	-	9,669
20	Insurance - Health and Life	-	-	-	-	-	-	-	-
21	Advertising	-	-	-	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	-	-	-	-	-	-	20,000
23	Regulatory Comm Expense - Other	378	-	-	-	-	-	-	378
24	Bad Debt Expense	-	-	-	-	-	-	-	-
25	Miscellaneous Expense	227,855	-	-	-	998	-	-	228,853
26	Depreciation and Amortization	-	-	-	-	-	-	-	-
27	Interest on Security Deposits	2,988	-	-	-	-	-	-	2,988
28	Taxes other than Income	21,299	-	-	-	-	-	-	17,301
29	Property Taxes	22,873	-	-	-	-	(3,998)	-	18,489
30	Income Tax	498,869	-	-	1,568	998	(3,998)	(4,384)	493,053
31	Total Operating Expenses	\$ 73,882	\$ 7,359	-	\$ (1,568)	\$ (998)	\$ 3,998	\$ 4,384	\$ 87,057
	Operating Income								

References:
Column [A]: Company Schedule C-1
Column [B] - [G]: Schedule GTM-13 through GTM-17
Column [C]: Add Column [A] - Column [F]

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Schedule GTM-13

OPERATING INCOME ADJUSTMENT # 1 - ELIMINATE REVENUE ANNUALIZATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Metered Water Revenues	<u>\$ 559,013</u>	<u>\$ 7,359</u>	<u>\$ 566,372</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GTM Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GTM-14

OPERATING INCOME ADJUSTMENT # 2 - NOT USED

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		\$ -	\$ -	\$ -

References:

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Schedule GTM-15

OPERATING INCOME ADJUSTMENT # 3 - WATER TESTING EXPENSE

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Water Testing	<u>\$ 1,215</u>	<u>\$ 1,568</u>	<u>\$ 2,783</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GTM Testimony

Col [C]: Col. [A] + Col. [B]

OPERATING INCOME ADJUSTMENT # 4 - DEPRECIATION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Depreciation and Amortization	\$ 227,855	\$ 998	\$ 228,853

Line No.	ACCT NO.	DESCRIPTION	[A] Company Proposed PLANT IN SERVICE BALANCE	[B] STAFF DEPR. PLANT BALANCE	[C] STAFF RECOMMENDED RATE	[D] STAFF RECOMMENDED EXPENSE
Plant In Service						
2	301	Organization Cost	\$ 127,103	127,103	0.00%	\$ -
3	302	Franchise Cost	-	-	0.00%	-
4	303	Land and Land Rights	494,159	124,659	0.00%	-
5	304	Structures and Improvements	182,570	182,570	3.33%	6,080
6	305	Collecting and Impounding Res.	-	-	2.50%	-
7	306	Lake River and other Intakes	-	-	2.50%	-
8	307	Wells and Springs	386,591	386,591	3.33%	12,873
9	308	Infiltration Galleries and Tunnels	-	-	6.67%	-
10	309	Supply Mains	-	-	2.00%	-
11	310	Power Generation Equipment	-	-	5.00%	-
12	311	Electrical Pumping Equipment	968,652	968,652	12.50%	121,082
13	320.0	Water Treatment Equipment	15,947	-		-
14	320.1	Water Treatment Plant	-	-	3.33%	-
15	320.2	Chemical Solution Feeders	-	15,947	20.00%	3,189
16	330	Distribution Reservoirs & Standpipe	836,890	-		-
17	330	Storage Tanks	-	199,778	2.22%	9,989
18	330	Pressure Tanks	-	452,063	5.00%	9,041
19	331	Transmission and Distribution Mains	1,611,320	1,505,756	2.00%	30,115
20	333	Services	386,947	386,947	3.33%	12,885
21	334	Meters	94,263	94,263	8.33%	7,852
22	335	Hydrants	161,737	161,737	2.00%	3,235
23	336	Backflow Prevention Devices	-	-	6.67%	-
24	339	Other Plant & Miscellaneous Equipment	187,582	187,582	6.67%	12,512
25	340	Office Furniture & Fixtures	-	-	6.67%	-
26	340	Computers & Software	-	-	20.00%	-
27	341	Transportation Equipment	-	-	20.00%	-
28	342	Stores Equipment	-	-	4.00%	-
29	343	Tools and Work Equipment	-	-	5.00%	-
30	344	Laboratory Equipment	-	-	10.00%	-
31	345	Power Operated Equipment	-	-	5.00%	-
32	346	Communications Equipment	-	-	10.00%	-
33	347	Miscellaneous Equipment	-	-	10.00%	-
34	348	Other Tangible Plant	-	-	3.33%	-
35	-	Rounding Amount	-	-	67.00%	-
36		Subtotal General	\$ 5,453,761	\$ 4,793,648		\$ 228,853
37		Less: Non- depreciable Account(s)	621,262	251,762		
38		Depreciable Plant (L29-L30)	\$ 4,832,499	\$ 4,541,886		
39		Contributions-in-Aid-of-Construction (CIAC)			\$ -	
40		Weighted Average Depreciation/Amortization Rate			5.0387%	
41		Less: Amortization of CIAC (L32 x L33)				\$ -
42		Depreciation Expense - STAFF [Col. (C), L36 - L41]				\$ 228,853

OPERATING INCOME ADJUSTMENT # 5 - PROPERTY TAXES

LINE NO.	Property Tax Calculation	[A] STAFF AS ADJUSTED	[B] STAFF RECOMMENDED
1	Staff Adjusted Test Year Revenues - 2009	\$ 580,110	\$ 580,110
2	Weight Factor	2	2
3	Subtotal (Line 1 * Line 2)	\$ 1,160,220	\$ 1,160,220
4a	Staff Adjusted Test Year Revenues - 2006	580,110	
4b	Staff Recommended Revenue, Per Schedule GTM-1		700,939
5	Subtotal (Line 4 + Line 5)	\$ 1,740,330	\$ 1,861,159
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	\$ 580,110	\$ 620,386
8	Department of Revenue Multiplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	\$ 1,160,220	\$ 1,240,773
10	Plus: 10% of CWIP -		-
11	Less: Net Book Value of Licensed Vehicles		-
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$ 1,160,220	\$ 1,240,773
13	Assessment Ratio	20.0%	20.0%
14	Assessment Value (Line 12 * Line 13)	232,044	\$ 248,155
15	Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16)	7.4558%	7.4558%
16	Staff Proposed Property Tax Expense (Line 14 * Line 15)	\$ 17,301	
17	Company Proposed Property Tax	21,299	
18	Staff Test Year Adjustment (Line 16-Line 17)	\$ (3,998)	
19	Property Tax - Staff Recommended Revenue (Line 14 * Line 15)		\$ 18,502
20	Staff Test Year Adjusted Property Tax Expense (Line 16)		\$ 17,301
21	Increase/(Decrease) to Property Tax Expense		\$ 1,201
22	Decrease to Property Tax Expense		\$ 1,201
23	Increase in Revenue Requirement		120,829
24	Decrease to Property Tax per Dollar Increase in Revenue (Line19/Line 20)		0.994107%

References:

Col [A]: Company Schedule C-1 Page 3

Col [B]: GTM Testimony

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GTM-18

OPERATING INCOME ADJUSTMENT # 6 - INCOME TAXES

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Income Tax	\$ 22,873	\$ (4,384)	\$ 18,489
2				
3				
4				
5				
6				
7				
8				
9				
10				
11	<u>References:</u>			
12	Col [A]: Company Schedule C-1 Page 3			
13	Col [B]: Column [C] - Column [A]			
14	Col [C]: Schedule GTM-2			

RATE DESIGN

Monthly Usage Charge (all classes)	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" Meter - All Classes	\$ 42.20	\$ 56.97	\$ 47.50
3/4" Meter - All Classes	\$ 63.30	\$ 85.46	\$ 71.30
1" Meter - All Classes	\$ 105.50	\$ 142.43	\$ 119.00
1½" Meter - All Classes	\$ 211.50	\$ 284.85	\$ 238.00
2" Meter - All Classes	\$ 339.68	\$ 455.76	\$ 380.00
3" Meter - All Classes	\$ 675.20	\$ 911.52	\$ 760.00
4" Meter - All Classes	\$ 1,055.00	\$ 1,424.25	\$ 1,188.00
6" Meter - All Classes	\$ 2,110.00	\$ 2,848.50	\$ 2,375.00
Construction/Stand pipe	N/A	N/A	N/A
Commodity Rates (all classes)			
5/8" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.50
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 9,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
3/4" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.50
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 10,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
1" Meter			
From 1 to 22,500 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 22,500 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
1½" Meter			
From 1 to 34,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 34,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
2" Meter			
From 1 to 45,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 45,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
3" Meter			
From 1 to 68,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 68,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
4" Meter			
From 1 to 90,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 90,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
6" Meter (Res., Comm.)			
From 1 to 135,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.00
Over 135,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.00
Construction/Stand pipe (Res., Comm.)			
All Gallons	\$ 7.11	\$ 13.13	\$ 11.00

	Present	Co. Proposed			Staff Recommended		
Service Line and Meter Installation Charges	Total	Line	Meter	Total	Line	Meter	Total
5/8" Meter	\$ 225	\$ 385	\$ 135	\$ 520	\$ 385	\$ 135	\$ 520
3/4" Meter	270	415	205	620	415	205	620
1" Meter	300	465	265	730	465	265	730
1½" Meter	425	520	475	995	520	475	995
2" Turbine Meter	550	800	995	1,795	800	995	1,795
2" Compound Meter	550	800	1,840	2,640	800	1,840	2,640
3" Turbine Meter	750	1,015	1,620	2,635	1,015	1,620	2,635
3" Compound Meter	750	1,135	2,495	3,630	1,135	2,495	3,630
4" Turbine Meter	1,375	1,430	2,570	4,000	1,430	2,570	4,000
4" Compound Meter	1,375	1,610	3,545	5,155	1,610	3,545	5,155
6" Turbine Meter	2,800	2,150	4,925	7,075	2,150	4,925	7,075
6" Compound Meter	2,800	2,270	6,820	9,090	2,270	6,820	9,090
8"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
10"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
12"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
Service Charges							
Establishment	\$ 50.00			\$ 50.00			\$ 50.00
Establishment (After Hours)	75.00			75.00			NT
Reconnection (Delinquent)	75.00			75.00			75.00
Reconnection (After Hours)	50.00			50.00			NT
Meter Test	20.00			20.00			20.00
Deposit Requirement (Residential)	(a)			(a)			(a)
Deposit Requirement (None Residential Meter)	(a)			(a)			(a)
Deposit Interest	6.00%			6.00%			6.00%
Re-Establishment (With-in 12 Months)	(b)			(b)			(b)
NSF Check	15.00			15.00			15.00
Deferred Payment, Per Month	1.5%			1.50%			1.50%
Meter Re-Read	20.00			20.00			20.00
Late Charge per month	1.5%			1.5%			1.5%
Customer Requested Meter Test	20.00			20.00			20.00
After Hours Service Charge	10.00			10.00			50.00
Turn-on/off (at customer request)	NT			75.00			NT
Moving Customer Meter (at customer request)	NT			cost			cost
NT = No Tariff							
Monthly Service Charge for Fire Sprinkler							
All Meter Sizes					Greater of \$10 or 2 percent of the general service rate for a similar size meter.		

Per Commission Rules (R14-2-403.B)

- (a) Residential - two times the average bill. Non-residential - two and one-half times the average bill.
- (b) Minimum charge times number of months disconnected.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission Rule (14-2-409.D.5).

All advances and/or contributions are to include labor, materials, overheads and all applicable taxes.
Cost to include labor, materials and parts, overheads and all applicable taxes.

Typical Bill Analysis
Residential 5/8 Inch Meter

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	5,477	\$ 66.73	\$ 100.30	\$ 33.57	50.31%
Median Usage	4,500	60.96	89.63	\$ 28.68	47.04%
Staff Recommended					
Average Usage	5,477	\$ 66.73	\$ 83.29	\$ 16.56	24.82%
Median Usage	4,500	60.96	74.50	\$ 13.55	22.22%

Present & Proposed Rates (Without Taxes)
Residential 5/8 Inch Meter

Consumption	Rates	Rates	Increase	Rates	Increase
-	\$ 42.20	\$ 56.97	35.00%	\$ 47.50	12.56%
1,000	46.15	63.77	38.18%	52.00	12.68%
2,000	50.10	70.57	40.86%	56.50	12.77%
3,000	54.05	77.37	43.15%	61.00	12.86%
4,000	58.00	84.17	45.12%	70.00	20.69%
4,500	60.96	89.63	47.04%	74.50	22.22%
5,000	63.91	95.09	48.79%	79.00	23.61%
5,477	66.73	100.30	50.31%	83.29	24.82%
6,000	69.82	106.01	51.83%	88.00	26.04%
7,000	75.73	116.93	54.40%	97.00	28.09%
8,000	81.64	127.85	56.60%	106.00	29.84%
9,000	87.55	138.77	58.50%	115.00	31.35%
10,000	94.66	151.90	60.47%	126.00	33.11%
11,000	101.77	165.03	62.16%	137.00	34.62%
12,000	108.88	178.16	63.63%	148.00	35.93%
13,000	115.99	191.29	64.92%	159.00	37.08%
14,000	123.10	204.42	66.06%	170.00	38.10%
15,000	130.21	217.55	67.08%	181.00	39.01%
16,000	137.32	230.68	67.99%	192.00	39.82%
17,000	144.43	243.81	68.81%	203.00	40.55%
18,000	151.54	256.94	69.55%	214.00	41.22%
19,000	158.65	270.07	70.23%	225.00	41.82%
20,000	165.76	283.20	70.85%	236.00	42.37%
25,000	201.31	348.85	73.29%	291.00	44.55%
30,000	236.86	414.50	75.00%	346.00	46.08%
35,000	272.41	480.15	76.26%	401.00	47.20%
40,000	307.96	545.80	77.23%	456.00	48.07%
45,000	343.51	611.45	78.00%	511.00	48.76%
50,000	379.06	677.10	78.63%	566.00	49.32%
75,000	556.81	1,005.35	80.56%	841.00	51.04%
100,000	734.56	1,333.60	81.55%	1,116.00	51.93%

BEFORE THE ARIZONA CORPORATION COMMISSION

GARY PIERCE
Chairman
BOB STUMP
Commissioner
SANDRA D. KENNEDY
Commissioner
PAUL NEWMAN
Commissioner
BRENDA BURNS
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. W-02500A-10-0382
GOODMAN WATER COMPANY FOR AN)
INCREASE IN ITS WATER RATES)
FOR CUSTOMERS WITHIN PINAL)
COUNTY, ARIZONA)
_____)

SURREBUTTAL

TESTIMONY

OF

GORDON L. FOX

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JUNE 13, 2011

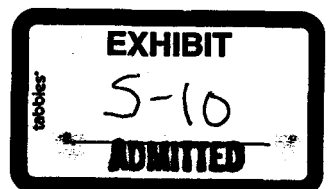


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**EXECUTIVE SUMMARY
GOODMAN WATER COMPANY
DOCKET NO. W-02500A-10-0382**

Goodman Water Company ("Goodman" or "Company") is an Arizona for-profit, Class C public service corporation providing water service to approximately 600 customers in the vicinity of Oracle in Pinal County, Arizona. On September 17, 2010, Goodman filed a general rate application. The application shows that Goodman posted a \$73,882 adjusted operating income for the test year that ended December 31, 2009. Goodman's application requests a \$291,454 (50.9 percent) revenue increase to provide a \$253,194 operating income for a 10.54 percent rate of return on a \$2,402,222 fair value rate base. Goodman's rebuttal testimony requests a 262,717 (44.19 percent) revenue increase to provide a \$227,309 operating income for a 9.89 percent rate of return on a \$2,298,376 fair value rate base.

The surrebuttal testimony of Staff witness Mr. Gordon L. Fox addresses rate base, operating income, revenue requirement and rate design issues.

Staff's surrebuttal revenue requirement of \$775,283 represents an increase of \$180,824, or 30.24 percent, over test year revenue of \$594,459 for a 9.2 percent rate of return on a Staff adjusted OCRB of \$1,974,781. Staff's surrebuttal revenue requirement represents a \$74,344 increase from its direct testimony. Staff's recommendation reflects eight rate base adjustments for a \$427,441 reduction and seven operating income adjustments for a \$1,735 increase in adjusted test year operating income.

The present rate structure for the residential, commercial, and construction customer classes consists of an inverted three-tier commodity rate for 5/8 x 3/4-inch and 3/4-inch meters. An inverted two-tier commodity rate structure applies to larger meters. A minimum monthly fixed charge that increases by meter size is also applicable to residential and commercial customers.

The Company rebuttal proposes a rate structure similar to the present rate structure that collects a greater proportion of the revenue from the commodity rates and spreads the rates between the tiers by a greater ratio by increasing the ratio between the first and second tiers for 5/8 x 3/4-inch and 3/4-inch meters. On average, the Company's proposed rates increase by 44.7 percent to achieve its proposed revenue requirement.

Staff's surrebuttal rate structure and the Company's rebuttal rate structure are similar with the same break-over points, similar percentages of revenue recovered through the monthly minimum charges and the commodity rates. Staff's recommended rate design would generate Staff's surrebuttal water revenue requirement of \$775,283 composed of \$761,545 from water services and \$13,738 from other revenues. Staff's recommended rates would increase the typical residential water bill with median month usage of 4,500 gallons by \$19.07, or 31.29 percent, from \$60.96 to \$80.03.

Rebuttal Testimony of Thomas J. Bourassa

Accounting Order for Depreciation on Excess Capacity - The Commission should deny the Company's request for an accounting order to defer depreciation expense on any plant the Commission excludes from rate base that represents excess capacity.

Land Parcels - Staff recommends valuing the four land parcels at the lower of the market price or net book carrying value by EC Development if and when the Company provides sufficient support for such a determination.

Rebuttal Testimony of James A. Shiner

Written Policies - Staff continues to advocate that the Company develop and implement written policies to guide the Company in affiliate and hiring of outside consultants.

Rebuttal Testimony of Michael J. Naifeh

Appraisal Comments - Staff retracts that portion of Mr. McMurry's direct testimony that states his appraisal was flawed. However, Staff does not recognize Mr. Naifeh as independent for the land parcel transactions or the Company. Mr. Naifeh's lack of independence neither suggests a concern of his abilities as an appraiser nor his personal integrity.

Rebuttal Testimony of John Ferenchak III

Appraisal Comments - Staff has no direct concern with accepting Mr. Ferenchak III's appraisal for the land parcels, and Staff has neither reason to doubt his abilities as an appraiser nor to question his personal integrity; however, the circumstances of the appraisal call for a professional level of skepticism.

Rebuttal Testimony of James Schoemperlen

Projected Returns - Mr. Schoemperlen correctly observes that since the mix of fixed and variable costs do not remain constant with customer/revenue growth, recognizing the plant values for capacity in excess of test year customers will result in growth in returns. However, the regulatory framework recognizes this benefit to utilities. The regulatory framework has both regulatory benefits and liabilities and regulators are challenged to find an optimal balance between the benefits and liabilities, not necessarily to eliminate them.

Rebuttal Testimony of James Wawrzyniak

Customer Communications - Staff has revised its reported statistical data to opinions and complaints. Mr. Wawrzyniak's testimony provides a summary of opinions and complaints filed with the Commission. This appears to be raw data. Staff has found individuals and households sometimes file multiple communications, and Staff's reported communications reflect removal of multiple opinions and complaints from a single individual or household. Accordingly, Staff's reported statistics will not agree with the raw data.

1 **I. INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Gordon L. Fox. I am a Public Utilities Analyst Manager employed by the
4 Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division
5 ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Briefly describe your responsibilities as a Public Utilities Analyst Manager.**

8 A. In my capacity as a Public Utilities Analyst Manager, I supervise analysts whose duties
9 include preparation of testimonies to provide the Commission with Staff recommendations
10 regarding rate base, operating income, cost of capital, rate design, securities issuance and
11 other financial regulatory matters.

12
13 **Q. Please describe your educational background and professional experience.**

14 A. I have twenty years of regulatory utility auditing and rate analysis experience (17 years at
15 the Commission and 3 years at RUCO) and four years of experience with a cable TV
16 utility with responsibility for preparing and presenting rate applications before
17 jurisdictional authorities. I have master and bachelor degrees in Accounting, and I have
18 earned the following professional accounting and finance certifications: Certified Public
19 Accountant ("CPA"), Certified Management Accountant ("CMA") and Certified in
20 Financial Management ("CFM").

21
22 **Q. Did you previously file direct testimony in this proceeding?**

23 A. No. Staff's direct testimony regarding rate base, operating income, revenue requirement
24 and rate design was filed by Mr. Gary T. McMurry. I am adopting Mr. McMurry's direct
25 testimony as modified herein.

II. PURPOSE OF SURREBUTTAL TESTIMONY

Q. What is the purpose of your Surrebuttal Testimony in this proceeding?

A. The purpose of my Surrebuttal Testimony in this proceeding is to respond on behalf of Staff to the Rebuttal Testimonies of Goodman Water Company ("Goodman" or "Company") witnesses Thomas J. Bourassa, James A. Shiner, Mark Taylor, Michael J. Naifeh, and John Ferenchak III and to intervenors James Schoemperlen, and Lawrence Wawrzyniak who represent Southland Utilities Company, Inc. ("Southland" or "Company") and to present Staff's surrebuttal position regarding rate base, operating income, revenue requirement and rate design issues. Staff witness Marlin Scott is presenting the engineering analysis and recommendations. Staff witness Juan Manrique is presenting the cost of capital analysis and recommendations.

Q. Has Staff attempted to address every issue raised by the Company in its Rebuttal Testimony?

A. No. Staff's silence on any particular issue raised in the Company's or intervenors' Rebuttal Testimonies does not indicate that Staff agrees with the stated Rebuttal position on the issue.

Q. Have you prepared any schedules to accompany your testimony?

A. Yes. I prepared Surrebuttal Schedules GLF-1 to GLF-20. The surrebuttal schedules reflect the Company's application as filed, not its rebuttal position.

1 **Q. How is your surrebuttal testimony organized?**

2 A. My testimony is presented in five sections. Section I is the introduction. Section II is this
3 description/purpose of my testimony. Section III provides a background of the Company.
4 Section IV is a summary of consumer service issues. Section V is a summary of proposed
5 revenues. Section VI is a summary of Staff's rate base and operating income adjustments.
6 Section VII presents Staff's rate base recommendations. Section VIII presents Staff's
7 operating income recommendations. Section IX discusses the Company's affiliated party
8 transactions. Section X discusses rate design. Section XI presents my responses to the
9 rebuttal testimony provided by Company witness Thomas J. Bourassa. Section XII
10 presents my responses to the rebuttal testimony provided by Company witness James A.
11 Shiner. Section XIII presents my responses to the rebuttal testimony provided by
12 Company witness Mark Taylor. Section XIV presents my responses to the rebuttal
13 testimony provided by Company witness Michael J Neifeh. Section XV presents my
14 responses to the rebuttal testimony provided by Company witness John Ferenchak III.
15 Section XVI presents my responses to the rebuttal testimony provided by intervenor James
16 Schoemperlen. Section XVII presents my responses to the rebuttal testimony provided by
17 intervenor Lawrence Wawrzyniak.

18
19 **III. BACKGROUND**

20 **Q. Would you please review the pertinent background information associated with the**
21 **Company's application for a permanent rate increase?**

22 A. Goodman is a class C public service corporation that provides water service to
23 approximately 600 customers in the vicinity of the town of Oracle in Pinal County,
24 Arizona. On September 17, 2010, Goodman filed an application for approval of
25 permanent rates and charges for water service, and on November 5, 2010, Staff filed a
26 letter declaring the application sufficient. Goodman's application asserts that an increase

1 in revenues is required to recover operating expenses and to provide debt service coverage
2 and a 10.54 percent return on fair value rate base ("FVRB").
3

4 **Q. What test year did Goodman use in its filing?**

5 A. Goodman's rate filing is based on the twelve-month period that ended December 31, 2009.
6

7 **Q. When were Goodman's present rates established?**

8 A. The Commission Decision No. 69404, dated April 16, 2007, granted the Company its
9 present permanent rates.
10

11 **Q. Does Goodman have any other cases currently pending before the Commission?**

12 A. No.
13

14 **IV. CONSUMER SERVICE**

15 **Q. Please provide a brief summary of customer complaints received by the Commission**
16 **regarding Goodman Utilities.**

17 A. Staff reviewed the Commission's records for the period January 1, 2008, through March 7,
18 2011, and found the following: 2008 - one complaint (billing); 2009 - one complaint
19 (billing); 2010 - zero complaints, 245 individual opinions opposed to the rate increase and
20 one petition with 22 signatories; and 2011 - one complaint and three opinions opposed to
21 the rate increase.¹ The Company is in good standing with the Corporations Division. The
22 Company is current on all property and sales taxes.

¹ The reported communications reflect removal of multiple opinions and complaints from a single individual or household.

1 **V. SUMMARY OF PROPOSED AND RECOMMENDED REVENUES**

2 **Q. What rebuttal revenue requirement is Goodman proposing?**

3 A. The Company's rebuttal testimony proposes total operating revenue of 857,176,² an
4 increase of \$262,717, or 44.19 percent, over its test year revenue of \$594,459. The
5 Company's rebuttal request claims to provide an operating income of \$227,309 for 9.89
6 percent rate of return on a \$2,298,376 fair value rate base ("FVRB") which is the same as
7 the proposed original cost rate base ("OCRB").
8

9 **Q. Please provide a summary of Staff's surrebuttal recommendations.**

10 A. Staff's surrebuttal revenue requirement of \$775,283 represents an increase of \$180,824, or
11 30.42 percent, over test year revenue of \$594,459 for a 9.2 percent rate of return on a Staff
12 adjusted OCRB of \$1,974,781. This surrebuttal revenue requirement represents a \$74,344
13 increase from Staff's direct testimony. Staff's recommended rates would increase the
14 typical residential water bill with median month usage of 4,500 gallons by \$19.07, or
15 31.29 percent, from \$60.96 to \$80.03.
16

17 **Q. Explain the primary reasons that Staff's surrebuttal revenue requirement differs**
18 **from that in its direct testimony.**

19 A. Staff's surrebuttal position reflects the following modifications to its direct position: the
20 rate of return increased from 9.0 percent to 9.2 percent due to an increase in the cost of
21 equity from 9.1 percent to 9.3 percent; operating revenue increased by \$14,349; operating
22 expenses by \$22,387; and rate base increased by \$235,069.
23

24 Surrebuttal Schedules GLF-1 to GLF-20 present the detail and results of Staff's
25 adjustments.

² This is a \$7,029 decrease from the \$864,205 revenue requested in the rate application.

1 **VI. SUMMARY OF STAFF'S RATE BASE AND OPERATING INCOME**
2 **ADJUSTMENTS**

3 **Q. Please summarize Staff's rate base and operating income adjustments.³**

4 **A. Rate Base:**

5 Land Purchase – This adjustment decreases the cost basis of the Company's 2008 land
6 purchase by \$379,837 because this non-arm's-length transaction was belatedly recorded
7 and other factors.

8
9 Reclassify Water Treatment Plant – This adjustment reclassifies \$15,947 in funds from
10 G/L account 320 "Water Treatment Plant" to G/L account 320.2 "Chemical Solution
11 Feeders."

12
13 Reclassify Distribution Reservoirs

14 This adjustment reclassifies \$836,890 from G/L account 330 "Distribution Reservoirs"
15 between two G/L accounts; 330.1 "Storage Tanks" and 330.2 "Pressure Tanks."

16
17 Remove cost of upsizing storage tank with excess capacity

18 This adjustment removes the \$72,350 cost for a 190,000 gallon upsize of a water storage
19 tank that Staff and the Company agree represents excess capacity.

20
21 Eliminate Transmission Mains

22 This adjustment eliminates \$128,600 from transmission mains to reflect lines that Staff
23 has deemed to be not used or useful.

³ Unless stated otherwise, Staff's adjustments throughout the testimony are to the Company's application, not to its rebuttal position.

1 Adjust accumulated depreciation

2 This adjustment decreases the accumulated depreciation balance by \$7,910 to reflect Staff
3 recommended plant values.

4
5 B. Operating Income:

6 Revenue Annualization – This adjustment increases test year revenues by \$21,708 to
7 recognize customer growth during the test year in agreement with the Company's rebuttal
8 testimony.

9
10 Annualize Purchased Power Expense – This adjustment increases purchased power
11 expense by \$577 to reflect the increase in cost associated with the increased water sales
12 from annualization of revenues, and it adopts the amount requested by the Company in its
13 rebuttal testimony.

14
15 Rate Case Expense – This adjustment increases rate case expense by \$20,000 to reflect a
16 normalized amount of \$40,000 which is the annual amount requested by the Company in
17 its rebuttal testimony.

18
19 Water Testing Expense – This adjustment increases water testing expense by \$1,568 to
20 reflect Staff's recommended water testing expense. The Company's rebuttal testimony
21 adopts Staff adjustment.

22
23 Depreciation Expense – This adjustment increases depreciation expense by \$11,047 to
24 reflect application of Staff's recommended depreciation rates to Staff-recommended plant
25 amounts.

1 Property Taxes – This adjustment decreases test year property taxes by \$2,250 to reflect
2 application of the modified version of the Arizona Department of Revenue's property tax
3 methodology which the Commission has consistently adopted.

4
5 Test Year Income Taxes – This adjustment decreases test year income tax expense by
6 \$9,496 to reflect application of statutory state and federal income tax rates to Staff-
7 adjusted taxable income.

8
9 **VII. RATE BASE**

10 **Fair Value Rate Base**

11 **Q. Does Goodman's application include schedules with elements of a Reconstruction**
12 **Cost New Rate Base?**

13 A. No. The Company's application does not request recognition of a Reconstruction Cost
14 New Rate Base. Accordingly, Staff has treated the Company's OCRB as its FVRB.

15
16 **Rate Base Summary**

17 **Q. Please summarize Staff's surrebuttal rate base recommendation.**

18 A. Staff recommends a \$1,974,781 FVRB, a \$427,441 reduction from the \$2,402,222 rate
19 base proposed in the application, and it is \$323,595 less than the Company's \$2,298,376
20 rebuttal testimony rate base. Staff's recommendation results from the rate base
21 adjustments described below.

Rate Base Adjustment No. 1 – Reduce Cost Basis for Land Purchase

Q. What did the Company propose in its application with respect to land in the test year?

A. Schedule B-2, page 3, line 7, of the Company's application shows that the Company recorded a balance in the land and land rights account of \$494,159. The entire balance was due to the 2008 purchase of four parcels of land from an affiliated party, EC Development, Inc.

Q. Did the Company's rebuttal testimony propose a modified value for the land?

A. Yes. The Company's rebuttal reduced the land value by \$35,000 to \$459,159.⁴

Q. Is there any reason to question the value the Company used to record the land?

A. Yes. Staff has identified multiple reasons to question the recorded value of the land. First, the transaction was not recorded at cost at the time the land was placed in service. Second, the transaction was not at arm's length, and the Company has not shown that the transaction was recorded in accordance with NARUC audit guidelines for affiliate transactions. Third, the land appraisal used to value the transaction was conducted by an appraiser that was not independent from the Company.

Q. Did the Company record the land in its records on the date that the land was devoted to public service?

A. No. The Company recorded the acquisition of four land parcels in its general ledger on October 31, 2008.⁵ The Company provided the following dates for property on land: parcel one, June 2003; parcel two, 2004 & 2005; parcel three, 2007 & 2008; and parcel

⁴ Bourassa rebuttal p. 3 and Schedule B-2, p. 3.

⁵ Company response to Staff data request 4.13.

1 four, June 2003.⁶ According to this Company provided information, each of the four
2 parcels was placed into service between one and five years prior to the recorded in-service
3 date. Fixed assets should be recorded at the time it is devoted to public service.
4

5 **Q. What caused the Company to delay recording the land until long after it was placed**
6 **into service?**

7 A. According to the Company, it was an inadvertent oversight at that point of time.⁷
8

9 **Q. What is the relationship between the Company and the land seller?**

10 A. Goodman purchased the four parcels of real estate from EC Development for \$490,000.
11 EC Development is owned by Alex Sears and James Shiner.⁸ Mr. Sears and Mr. Shiner
12 are both owners of Goodman. In response to Staff data request GTM-1.11, the Company
13 identified EC Development, Mr. Sears and Mr. Shiner among others, as affiliates of the
14 Company.
15

16 **Q. What is the concern regarding non-arm's length transactions?**

17 A. Non-arm's length transactions are suspect of self-dealing and may not be conducted at
18 market price. The purchaser of the land, in this case, is related to the seller of the land. In
19 such cases, it is not clear whether the price paid for the real estate was truly market value.

⁶ Company witness Mr. Ferencak III uses different and more precise dates in his appraisal as follows: parcel one, May 1, 2002; parcel two, August 1, 2005; parcel three, January 1, 2008; and parcel four, October 1, 2004.

⁷ Mr. Bourassa rebuttal, p. 3 and Company response to Staff data request GTM-7.9.

⁸ Company response to Staff data request 4.03.

1 **Q. According to NARUC Guidelines for Cost Allocations and Affiliate Transactions**
2 **(“Guidelines”), what is an appropriate basis for recording the transfer of a capital**
3 **asset from an affiliate to a utility?**

4 **A. Generally, the transfer of assets from an affiliate to the utility should be at the lower of**
5 **prevailing market price or net book value, and an appraisal should be used to determine**
6 **the market price.**

7
8 **Q. What is Staff response to Mr. Bourassa’s comments that “This document specifically**
9 **states that the Guidelines are not intended to be rules or regulations prescribing how**
10 **cost allocation and affiliate transaction are to be handled? Further, the Guidelines**
11 **also state that the transfer of an asset from an affiliate to the utility should be at the**
12 **lower of cost or prevailing market price or net book value, *except by law or***
13 ***regulation*. In that regard, the Commission rules require that assets be recorded at**
14 **the cost to the person (or company) *first devoted to public service*. And, the cost is the**
15 ***cost at the time the asset is devoted to public service.*”⁹**

16 **A. Apparently, Mr. Bourassa believes that the amount that is recorded in a non-arm’s length**
17 **transaction represents cost. The recorded amount in a non-arm’s length transaction does**
18 **not provide a reliable representation of market value or cost. The fundamental concern**
19 **with affiliate transactions is that those transactions may not be recorded at a cost that**
20 **represents market price. The Guidelines address this concern by suggesting that the**
21 **appropriate amount to value affiliate transactions is the lower of market price or net book**
22 **value.**

⁹ Bourassa rebuttal, p. 5.

1 **Q. Has the Company shown that the transaction for the land was recorded in**
2 **accordance with NARUC audit guidelines for affiliate transactions?**

3 A. No. The Company has not provided the book value of the land carried by the seller.
4

5 **Q. Has Goodman been asked to provide the book value of the land carried by EC**
6 **Development?**

7 A. Yes. The following is the joint data request 5.01 from intervenors Mr. Wawrzyniak and
8 Mr. Schoemperlen and Goodman's response.
9

10 Question: Please supply the EC Development value of the four land
11 parcels for the Water Plant and Wells that Goodman Water Company
12 purchase from your affiliate EC Development in 2008.

13 Response: Goodman Water Company objects to this question on the
14 ground(s) that the information therein is irrelevant and it is unlikely to lead
15 to the discovery of relevant information. What may be relevant is what
16 the market value of the four (4) parcels in question was at the time(s) each
17 was devoted to public service by Goodman Water Company; and that
18 information was provided in the prepared Rebuttal Testimony of
19 Goodman Water Company, which the Individual Intervenors have
20 previously received.
21

22 Finally, E.C. Development and Goodman Ranch Associates did not carry
23 any specific land values on their respective books for the four (4)
24 specifically-sized parcels which are the subject of this data request. Land
25 values were carried for larger parcels of acreage, and those land values are
26 both proprietary and irrelevant to this proceeding.

1 **Q. Can Staff identify any reason why EC Development's carrying value of the four land**
2 **parcels is relevant to this case?**

3 A. Yes. As discussed above, according to the Guidelines, the transfer of assets from an
4 affiliate to a utility generally should be at the lower of prevailing market price or net book
5 value. Since the seller, EC Development, is an affiliate of the buyer, Goodman, it is
6 necessary to have both EC Development's carrying value and the market value of the land
7 parcels to determine the appropriate value to record the land parcels.

8
9 **Q. Is Goodman relieved of its obligation to provide EC Development's carrying value of**
10 **the land parcels purchased if the purchased parcels were subsections of larger**
11 **parcels on EC Development's books?**

12 A. No. Goodman has the obligation to provide appropriate support for the values it proposes.
13 Goodman could have proposed a method for assigning or allocating portions of the larger
14 parcel valuations to the parcels acquired.

15
16 **Q. What did the Company use to determine the basis for the amount to record the land?**

17 A. The Company recorded the land's acquisition price based on a Summary Appraisal Report
18 performed by Michael Naifeh, MAI, CRE, dated June 26, 2008.

19
20 **Q. Is an appraisal an appropriate method for valuing a land transaction?**

21 A. Yes. Due to the unique nature of real property, a readily identifiable market price is not
22 available for land; accordingly, an appraisal may be the best alternative.

23
24 **Q. Who performed the appraisal to support the recorded value of the land parcels?**

25 A. Mr. Naifeh prepared the appraisal dated June 26, 2008.

1 **Q. Was Mr. Naifeh independent of the transaction to sell the land parcels?**

2 A. Mr. Naifeh's rebuttal testimony asserts that: (1) Mr. Sears, an owner of Goodman, through
3 D&D Investment West L.L.C. invested approximately \$300,000 in a \$19,000,000 property
4 in Flagstaff; (2) Mr. Naifeh organized the investment group that purchased the Flagstaff
5 property; and (3) Mr. Naifeh has prepared less than five appraisals directly for Mr. Sears.¹⁰
6 Thus, Mr. Naifeh has an indirect relationship with the land transaction and a historical
7 business relationship with Mr. Sears. In fact, Mr. Naifeh disclosed in his appraisal that he
8 had a financial interest related indirectly to the transaction. Accordingly, Mr. Naifeh is
9 not independent of the transaction to acquire the land parcels.

10

11 **Q. Does Mr. Naifeh's lack of independence mean that he engaged in any impropriety?**

12 A. No. Staff is not suggesting that Mr. Naifeh did anything inappropriate. Staff is neither
13 questioning his abilities as an appraiser nor his personal integrity. However,
14 independence is a fundamental characteristic of objectivity. Therefore, Mr. Naifeh's lack
15 of independence taints the appraisal. Mr. Naifeh's disclosure of his non-independence
16 related to the transaction, professional dedication and commitments, certification that the
17 appraisal was unbiased and the relatively small investments involved with the common
18 interests are potential mitigating elements, but his lack of independence by its nature
19 places some circumspection on the results.

20

21 **Q. What is the basis for the Company's rebuttal land valuation of \$459,159?**

22 A. The Company's rebuttal testimony reduces the land valuation by \$35,000 from \$494,159
23 to \$459,159¹¹ based on a appraisal dated April 29, 2011, performed by a different
24 appraiser, Mr. Ferenchak III.

¹⁰ Naifeh rebuttal, p. 7.

¹¹ Closing costs, \$2,159; Appraisal fee \$2,000.

1 **Q. Why did the Company request Mr. Ferenchak III to perform an appraisal?**

2 A. The Company retained Mr. Ferenchak III to perform an appraisal to resolve both the issue
3 of Mr. Naihef's independence and the date of valuation.¹²
4

5 **Q. Is Staff aware of any reason to question that Mr. Ferenchak III is independent in**
6 **relation to either the Company or the transaction?**

7 A. No. Mr. Ferenchak III asserts that he has no present or prospective interest in the parcels
8 and no personal interest with respect to the parties involved.¹³ Staff is not aware of any
9 reason to question that Mr. Ferenchak III is independent from the Company or the
10 transaction.
11

12 **Q. Does Mr. Ferenchak III's appraisal purport to provide an appraisal for the land**
13 **parcels that match the dates that the parcels were committed to public service?**

14 A. Yes. The appraisal purports to have provided evaluations consistent with the in-service
15 dates of the land parcels, i.e., parcel one, May 1, 2002; parcel two, August 1, 2005; parcel
16 three, January 1, 2008; and parcel four, October 1, 2004.¹⁴
17

18 **Q. Does Staff have any reservations about accepting Mr. Ferenchak III's appraisal as**
19 **the market value for the land parcels?**

20 A. Staff has no direct concern with accepting Mr. Ferenchak III's appraisal for the land
21 parcels, and Staff has neither reason to doubt his abilities as an appraiser nor to question
22 his personal integrity.
23

¹² Bourassa rebuttal, p.8.

¹³ Ferenchak III rebuttal, Attachment A, p. 35.

¹⁴ These dates are difference and more precise than the dates provided in response to Staff data request GTM-7.9.

1 Nevertheless, it would be remiss to ignore that the history (a non-arm's length transaction,
2 not recorded at the time required by the USOA, and an initial appraisal by a non-
3 independent appraiser) and that the circumstances provided the Company an incentive to
4 obtain a high appraisal valuation for the land parcel and to seek to find an appraiser that
5 would render a favorable conclusion. That is, the circumstances warrant application of a
6 healthy level of professional skepticism. The need for skepticism is exacerbated by the
7 Company's assertion that its failure to record the transactions at the time the parcels were
8 devoted to public service was nothing more than an oversight¹⁵ in consideration of the
9 Company's description of the complexity of the transaction as ultimately executed in
10 2008. Goodman paid \$2,000 for an appraisal, \$2,159 for closing costs and it purchased
11 the land for consideration of \$271,000 (1.552 shares) in Goodman Water Company stock,
12 \$115,000 cash at close of escrow and \$98,400 in seller financing.¹⁶ These actions indicate
13 that this was not a nonchalant transaction that would simply have been overlooked
14 initially.

15
16 **Q. Assuming that Mr. Ferenchak III's appraisal provides an accurate representation of**
17 **the market value of the land parcel at the times they were committed to public**
18 **service, are those the valuations that should be used to include the parcels in the rate**
19 **base in this case?**

20 **A. No.** As discussed above, the Guidelines call for recognizing the transactions at the lower
21 of prevailing market price or net book value. The appraisal does not provide the net book
22 value. Goodman has not provided the book value of the parcels as carried by EC
23 Development. The Company knows from Mr. McMurry's direct testimony¹⁷ that Staff is
24 recognizing the Guidelines as the appropriate basis for recording the transactions.

¹⁵ Bourassa rebuttal p. 3 and Company response to Staff data request GTM-7.9.

¹⁶ Company response to Staff data request GTM 4.3.

¹⁷ Gary McMurry direct p. 9.

1 Accordingly, if EC Development's net book value was higher than the market price, the
2 Company had a strong incentive to provide the book value in its rebuttal testimony to
3 demonstrate that the market price as determined by the appraisal was the appropriate
4 amount for valuing the transaction. The Company's non-disclosure of evidence regarding
5 the net book value of the parcels suggests that the appraised value exceeds the book value;
6 therefore, the appraised value is not the appropriate amount to recognize in rate base for
7 the parcels.

8
9 **Q. What is Staff's conclusion regarding the valuations for the land parcels?**

10 A. The Guidelines that generally call for recognizing the land transactions at the lower of
11 prevailing market price or net book value are the appropriate basis for recording the
12 transactions. The Company is responsible for supporting the amounts it claims in rate
13 base, and it has not provided the book values needed to properly value the parcel
14 consistent with the Guidelines. The land parcels should not be recognized at the appraised
15 values, and assumed higher values, due to the Company's unwillingness or inability to
16 support the claimed amounts. Ratepayers should not be disadvantaged due to the
17 Company's non-disclosure of information or inability to support its proposed valuations.

18
19 Accordingly, Staff concludes that the parcels should be recognized at the lower of the
20 market price or net book carrying value by EC Development. Since the Company has not
21 provided the latter, a proper determination of the parcels valuation cannot be made. Staff
22 concludes that the parcels should be excluded from rate base until the Company provides
23 appropriate supporting information. In the meantime, the 2009 Pinal County Assessor's
24 Full Cash Value ("FCV") for the four parcels is a reasonable place holder value. Staff
25 uses the FCV in rate base calculations only to provide a realistic representation of its
26 overall revenue requirement and rates.

1 **Q. What is Staff recommending?**

2 A. Staff recommends valuing the four land parcels at the lower of the market price or net
3 book carrying value by EC Development if and when the Company provides sufficient
4 support for such a determination. As a place holder, Staff is using the 2009 Pinal County
5 Assessor's FCV which results in a \$379,837¹⁸ reduction in the land's basis to \$114,322, as
6 shown in Surrebuttal Schedule GLF-5. Staff's land value is \$344,837 less than the
7 Company's rebuttal value of \$459,159.

8

9 **Rate Base Adjustment No. 2 – Reclassify Water Treatment Plant**

10 **Q. What did the Company propose in its initial application with respect to water**
11 **treatment equipment?**

12 A. Goodman proposed a balance of \$15,947 in account number 320, Water Treatment Plant.

13

14 **Q. Is general account number 320 normally divided into subaccounts?**

15 A. Yes. Normally, account number 320 is divided into subaccounts. Since there is a
16 significant difference in the expected lives of various water treatment equipment, it is
17 appropriate to establish subaccounts, each with its own depreciation rate.

18

19 **Q. What does Staff recommend with respect to the Water Treatment Equipment?**

20 A. Based on the Company's response to Staff data request GTM-1.5, Staff recommends
21 reclassifying \$15,947 to G/L account 320.2, Chemical Solution Feeders, as shown in
22 Surrebuttal Schedule GLF-6. The Company adopts Staff's recommendation in its rebuttal
23 testimony.¹⁹

¹⁸ Corrected from \$369,500 in Staff's direct testimony.

¹⁹ Bourassa rebuttal, p. 3.

Rate Base Adjustment No. 3 – Reclassify Distribution Reservoirs

Q. What did the Company propose in its initial application with respect to distribution reservoirs?

A. Goodman's application proposes \$836,890 in G/L account number 330, Distribution Reservoirs and Standpipe.

Q. Is general account number 330 normally divided into subaccounts?

A. Yes. Similar to the discussion above regarding Water Treatment Equipment, normally, account number 330, Distribution Reservoirs, is divided into subaccounts to recognize the various types of equipment and their respective lives, each with its own depreciation rate.

Q. What is Staff recommending?

A. Staff recommends reclassifying the \$836,890 from G/L account number 330, Distribution Reservoirs and Standpipe, to two sub-accounts: \$384,827 going to account 330.1, Storage Tanks, and \$452,063 going to account 330.2, Pressure Tanks, as shown in Surrebuttal Schedule GLF-7. The Company adopts Staff's recommendation in its rebuttal testimony.²⁰

Rate Base Adjustment No. 4 – Reduce Storage Tanks

Q. Does the Company's rebuttal testimony propose to reduce the initial filing amount claimed for storage tanks by \$72,350?

A. Yes. The Company witnesses agree that the 190,000 gallon upsized plant the storage tank at plant no. 3 valued at \$72,350 represents excess capacity,²¹ and Staff is accepting the Company's rebuttal position. Staff made the \$72,350 deduction from the \$384,827

²⁰ Bourassa rebuttal, p. 3.

²¹ Bourassa rebuttal, p. 3; Shiner rebuttal, p.14; Taylor rebuttal, p. 13.

1 reclassified to account number 330.1, Storage Tanks, as discussed in Staff Rate Base
2 Adjustment No. 3.

3
4 **Q. What is Staff recommending?**

5 A. Staff recommends an \$72,350 negative adjustment to the storage tanks balance, as shown
6 in Surrebuttal Schedule GLF-8. Staff's surrebuttal recommendation for a storage tank
7 balance of \$312,477 agrees with the Company's rebuttal balance.

8
9 **Rate Base Adjustment No. 5 – Reduce Transmission and Distribution Mains**

10 **Q. What did the Company propose with respect to transmission and distribution**
11 **mains?**

12 A. In the Company's application, it recorded \$1,611,320 in G/L account 331, Transmission
13 and Distribution Mains.

14
15 **Q. Does Staff have any revision to the \$105,564 amount removed from Transmission**
16 **and Distribution Mains in its direct testimony because of not used and useful plant?**

17 A. Yes. The surrebuttal testimony of Staff witness Marlin Scott, Jr. discusses why an
18 additional \$23,036 amount of the transmission mains are not used and useful to the
19 Company's ratepayers. Staff's recommended Transmission and Distribution Mains Value
20 is \$105,564 less than the Company rebuttal proposal of \$1,611,320.

21
22 **Q. What is Staff recommending?**

23 A. Staff recommends a decrease of \$128,600, as shown in Surrebuttal Schedule GLF-9, to
24 reflect the portion of plant determined to be not used or useful to the production of water
25 service by the Company.

Rate Base Adjustment No. 6 – Reduce Accumulated Depreciation

Q. What did the Company propose with respect to accumulated depreciation?

A. The Company's application proposed \$731,205 in accumulated depreciation reflecting a \$67,829 pro forma decrease from the end of test year recorded amount of \$799,034.

Q. Did the Company's rebuttal testimony propose a modifications to its proposed balance for accumulated depreciation?

A. Yes. The Company's rebuttal testimony increases the accumulated deprecation balance by \$2,510 to \$733,716 to reflect correction of a computational error and removal of accumulated depreciation on the 190,000 gallon storage tank upsizing that the Company is removing in its rebuttal testimony.²²

Q. Is Staff making a modification from the \$733,602 accumulated depreciation balance in its direct testimony?

A. Yes. Staff is making corrections due to computational errors. In addition, adjustments are necessary to reflect changes in Staff's recommended plant balances. Staff's rebuttal accumulated depreciation balance is \$723,295 as shown in Surrebuttal Schedule GLF-10.

Q. What is Staff recommending?

A. Staff recommends decreasing Accumulated Depreciation by \$7,910 from \$731,205 to \$723,295, as shown in Surrebuttal Schedule GLF-10. Staff's surrebuttal recommendation is \$10,421 less than the Company's rebuttal proposal of \$733,716.

²² Bourassa rebuttal, p. 3.

Rate Base Adjustment No. 7 – Advances in Aid of Construction

Q. Does Staff have any comment to the Company's assertion that all of the disallowances Staff recommends to Transmission and Distribution Mains were funded with AIAC, and if Staff's adjustment to the transmission and distribution mains is adopted an equal amount of AIAC must also be excluded from rate base?²³

A. Although the supporting data provided by the Company is insufficiently detailed to show with certainty that the plant Staff recommends be disallowed because it is not used and useful was funded by AIAC, the summary information tends to support that the Company used AIAC funding. The Company's claim that the plant in question was funded by AIAC is further supported by its policy to fund all non-backbone plant with AIAC. The Company's claim that the amount of AIAC excluded from rate base must equal the amount of disallowed plant will be correct only if no there have been no AIAC refunds. Since the plant is not used and useful, it is a reasonable conclusion that there have been no AIAC refunds in recognition that refund obligation are based on revenues generated. Accordingly, Staff concludes that the Company is correct that the disallowance of Transmission and Distribution Mains should be offset by an equal amount of AIAC.

Q. What is Staff recommending?

A. Staff recommends decreasing AIAC by \$128,600 from \$2,101,905 to \$1,973,305, as shown in Surrebuttal Schedule GLF-10.1. Staff's surrebuttal recommendation is \$128,600 less than the Company's rebuttal proposal of \$2,101,905.

²³ Bourassa rebuttal, pp. 12-14.

Rate Base Adjustment No. 8 – Accumulated Deferred Income Taxes

Q. What did the Company propose with respect to ADIT?

A. The Company's application proposed a \$135,342 ADIT credit (reduction to rate base). The entire amount represents a pro forma adjustment to the Company's records at the end of the test year.

Q. Did the Company's rebuttal testimony propose a modifications to its proposed balance for ADIT?

A. Yes. The Company's rebuttal testimony decreases from its direct testimony ADIT by \$5,713 to \$129,629 to reflect changes to plant, accumulated depreciation and AIAC.²⁴

Q. Does Staff have any comments regarding Mr. Bourassa's calculation of ADIT using Staff's direct testimony recommendations and assertion that Staff's ADIT recommendation should be reduced by approximately \$47,349 to \$87,994 from \$135,342?²⁵

A. Yes. First, Staff's review of Mr. Bourassa's methodology for calculation of ADIT did not identify any errors that would provide an incorrect ADIT balance assuming use of the correct input values. Second, although Staff did not identify any incorrect input values used in the calculation, it either does not have or could not locate the data necessary to verify the tax basis values used in the calculation. Third, Staff surrebuttal values for plant, accumulated depreciation and AIAC have been modified from its direct testimony rendering the ADIT calculation stale. Fourth, Staff has recalculated the ADIT balance to reflect its surrebuttal balances for plant, accumulated depreciation and AIAC and assuming the tax basis amounts provided in Mr. Bourassa calculations are correct. Staff's calculation results in an ADIT credit balance of \$118,506.

²⁴ Bourassa rebuttal, p. 30.

²⁵ Bourassa rebuttal, p. 31.

1 **Q. What is Staff recommending?**

2 A. Staff recommends decreasing the ADIT credit (liability) balance by \$16,936 from
3 \$135,342 to \$118,506, as shown in Surrebuttal Schedule GLF-10.2. Staff's surrebuttal
4 recommendation is \$10,821 less than the Company's rebuttal proposal of \$129,327.
5

6 **VIII. OPERATING INCOME**

7 **REVENUES**

8 **Q. Please summarize the results of Staff's examination of test year operating income.**

9 A. Staff determined a test year operating income of \$75,617, \$1,735 higher than the adjusted
10 test year operating income of \$73,882 in the Company's application, and it is \$1,673
11 higher than the adjusted operating income of \$73,944 in the Company's rebuttal
12 testimony. Staff's recommendation results from the operating income adjustments
13 described below.
14

15 **Operating Income Adjustment No. 1 – Revenue Annualization**

16 **Q. What does the Company application propose for operating revenues?**

17 A. The Company's direct testimony proposed the recorded test year revenues of \$580,110
18 less a \$7,359 pro forma revenue annualization adjustment for adjusted test year revenues
19 of \$572,751.
20

21 **Q. Does the Company's rebuttal testimony propose modifications to its direct testimony
22 in regard to test year operating revenue?**

23 A. Yes. The Company's rebuttal testimony modifies the annualization adjustment from a
24 \$7,359 decrease to a \$14,349 increase.²⁶ The modification results from the Company's

²⁶ Bourassa rebuttal, p. 35.

1 discovery that the original bill count did not contain billing determinants for zero usage or
2 reflect pro-rated bills.²⁷

3
4 **Q. Does Staff have comments regarding the Company's modified billing determinants**
5 **and test year revenue?**

6 A. Yes. The Company's revised annualization adjustment increases its proposed test year
7 revenue by \$21,708, from \$572,751 to \$594,459. Staff is recognizing the revised billing
8 determinants as correct. Staff had rejected the Company initial annualization adjustment
9 because it was inconsistent with trended revenues and customer growth data. The revised
10 annualization is consistent with this data, therefore, Staff is accepting the Company's
11 rebuttal annualization adjustment for test year revenues.

12
13 **Q. What is Staff recommending?**

14 A. Staff recommends increasing test year revenue by \$21,708, from \$572,751 to \$594,459
15 through recognition of an annualization adjustment, as shown in Surrebuttal Schedule
16 GLF-13. Staff's surrebuttal recommendation is the same as the Company's rebuttal
17 proposal.

18
19 **Operating Income Adjustment No. 2 – Rate Case Expense**

20 **Q. What did the Company propose for rate case expense in its application?**

21 A. The Company proposed \$80,000 amortized over four year, or \$20,000 per year.²⁸

²⁷ Bourassa rebuttal, p. 34.

²⁸ Bourassa rebuttal, p. 32.

1 **Q. Does the Company's rebuttal testimony propose modifications to its direct testimony**
2 **in regard to rate case expense?**

3 A. Yes. The Company's rebuttal testimony requests to amortize \$160,000 over four years, or
4 \$40,000 per year. The Company cite RUCO's intervention, major differences between the
5 parties unlikely to be resolved by the time of the hearing and having already incurred
6 \$84,000 prior to its rebuttal filing as reasons for the modification.²⁹

7
8 **Q. Does Staff agree that the Company's increased request for rate case expense is**
9 **reasonable?**

10 A. Yes. Staff agrees that that \$40,000 per year is a reasonable rate case expense. However,
11 Staff recommends recognizing \$40,000 per year as the normalized expense, not \$160,000
12 amortized over 4 years. Staff does not support establishing a regulatory asset for rate case
13 expense that may be recovered in subsequent rate cases if not fully recovered in the
14 intervening years.

15
16 **Q. What is Staff recommending?**

17 A. Staff recommends increasing rate case expense by \$20,000, from \$20,000 to \$40,000, as
18 shown in Surrebutal Schedule GLF-14. Staff's surrebuttal recommendation is the same as
19 the Company's rebuttal proposal in dollar amount, but it is achieve via different
20 accounting and ratemaking treatment as discussed above.

21

²⁹ Bourassa rebuttal, p. 33.

Operating Income Adjustment No. 3 – Water Testing Expense

Q. What is the Company proposing for Water Testing Expense?

A. Goodman's application proposes its actual recorded test year amount of \$1,215 for water testing.

Q. Is the Company's actual test year water testing expense representative of its average on-going expense?

A. No. Water testing expense varies from one year to the next based on the scheduled intervals for the various tests. Accordingly, water testing expense should be normalized. Staff has determined that the on-going average water testing expense should be \$2,783.

Q. Does the Company's rebuttal testimony propose modifications to its direct testimony in regard to test year water testing expense?

A. Yes. The Company's rebuttal testimony adopts Staff's \$1,568 adjustment to increase water testing expense to \$2,783.

Q. What is Staff recommending?

A. Staff recommends Water Testing expense of \$2,783, a \$1,568 increase from the Company's reclassified amount as shown in Surrebuttal Schedule GLF-15. Staff's surrebuttal recommendation is the same as the Company's rebuttal proposal.

Operating Income Adjustment No. 4 – Depreciation Expense

Q. What did the Company propose for Depreciation expense in its application?

A. The Company proposed its recorded test year depreciation expense of \$228,578 less a \$723 pro forma adjustment for \$227,855.

1 **Q. Does the Company's rebuttal testimony propose modifications to its direct testimony**
2 **in regard to depreciation testing expense?**

3 A. Yes. The Company's rebuttal testimony increases the proposed depreciation expense by
4 \$13,619 over the \$227,855 amount requested in its filing to \$241,474 due to changes in
5 plant values.

6
7 **Q. Has Staff also revised its recommended depreciation expense?**

8 A. Yes. As shown in Surrebuttal Schedule GLF-16, Staff recalculated depreciation expense
9 by applying Staff's recommended depreciation rates to Staff's recommended plant by
10 account. Staff calculated depreciation expense of \$238,902, an increase of \$11,047 from
11 the \$227,855 proposed by the Company in its application due to changes in recommended
12 plant values.

13
14 **Q. What is Staff recommending?**

15 A. Staff recommends \$238,902 for Depreciation expense, an \$11,047 increase from the
16 amount proposed in the Company's application, as shown in Surrebuttal Schedule GLF-
17 16. Staff's surrebuttal recommendation is \$2,572 less than the Company's rebuttal
18 proposal of \$241,474.

19
20 **Operating Income Adjustment No. 5 – Property Tax Expense**

21 **Q. What did the Company propose in its application for test year property tax expense?**

22 A. Goodman proposed \$21,299 for test year property taxes. The proposed amount is \$12,722
23 greater than the \$8,576 recorded in the test year. The Company calculated its proposed
24 amount using a modified version of the Arizona Department of Revenue's ("ADOR")
25 property tax method.

1 **Q. What method has the Commission typically adopted to determine property tax**
2 **expense for ratemaking purposes of Class B water utilities?**

3 A. The Commission's practice in recent years has been to use a modified ADOR
4 methodology for water and wastewater utilities.

5
6 **Q. Using the modified ADOR property tax method, what is the primary factor for**
7 **determining the amount of property tax calculated?**

8 A. The results from the modified ADOR methodology are primarily dependent upon revenue
9 inputs for three years. In the same manner as each operating income has a specific income
10 tax expense, there is a specific property tax expense for each three-year set of revenue
11 inputs. Therefore, the property tax expense calculated for the test year is different than the
12 property tax calculated for the authorized revenue. Only when the revenue inputs for all
13 three years is equal to the test year revenue will the resulting calculation reflect property
14 tax expense that correlates with the test year revenue. Since under the modified ADOR
15 method property tax expense is revenue-dependent in the same manner as is income tax
16 expense, property tax expense must be recalculated to reflect the authorized revenue.
17 Using inputs of one year of authorized revenue and two years of test year revenue in the
18 modified ADOR method provides the average expected property tax over a subsequent
19 three-year period. Use of one year of authorized revenue and two years of test year
20 revenue is consistent with the tax assessment lags used by ADOR.

21
22 **Q. What revenues did the Company use to calculate test year property tax expense?**

23 A. Schedule C-2, page 3, of the Company's application shows that it used one year of
24 proposed revenue and two years of test year revenues to calculate test year property tax
25 expense.

1 **Q. Did the Company's property tax calculations as proposed in its application reflect an**
2 **appropriate amount for test year property tax expense?**

3 A. No. As discussed above, only when the revenue input for all three years is equal to the
4 test year revenue will the resulting calculation using the modified ADOR method reflect
5 property taxes that correlate with test year revenue. Since the Company included one year
6 of proposed revenue in its calculation, its proposed test year property tax expense reflects
7 the on-going property tax expense, as opposed to test year expense, and will only reflect
8 the on-going expense if the Company's proposed revenue is adopted.

9
10 **Q. Has Staff developed a solution to address the dependent relationship between**
11 **Property Tax expense and revenues?**

12 A. Yes. Staff has included a factor for property taxes in the gross revenue conversion factor
13 ("GRCF") (see Surrebuttal Schedule GLF-2) that automatically adjusts the revenue
14 requirement for changes in revenue in the same way that income taxes are adjusted for
15 changes in operating income. This flexible method will accurately reflect property tax
16 expense at any authorized revenue level. This refinement allows for accurate calculation
17 of property tax expense at the test year revenue level, and for recovery of any additional
18 property tax expense incurred due to any increase in authorized revenue. It also removes
19 any necessity to present on-going property tax expense as test year property tax expense.
20 In using the GRCF to calculate the correct revenue requirement, the test year operating
21 income must be determined with property tax expense derived from the modified ADOR
22 method using test year revenue as the input for all three years.

1 **Q. Does the Company's rebuttal testimony propose modifications to its direct testimony**
2 **in regard to property tax expense?**

3 A. Yes. The Company's rebuttal testimony adopts the modified ADOR method used by
4 Staff. Accordingly, the difference between Staff's surrebuttal and the Company's rebuttal
5 property tax expense is primarily due to differences in revenue.

6
7 **Q. What is Staff's surrebuttal recommendation for test year property tax expense?**

8 A. Staff recommends \$19,049 for test year property tax expense, a \$2,250 reduction from the
9 Company's proposed amount of \$21,299, as shown in Surrebuttal Schedule GLF-17.³⁰
10 Staff further recommends adoption of its GRCF that includes a factor for property tax
11 expense, as shown in Surrebuttal Schedule GLF-2. Staff's surrebuttal recommendation is
12 \$886 less than the Company's rebuttal proposal of \$19,935.

13
14 **Operating Income Adjustment No. 6 – Income Tax Expense**

15 **Q. What did the Company propose in its application for test year income tax expense?**

16 A. Goodman proposed \$22,873 for test year income tax expense in its application. The
17 Company's test year income tax expense reflects application of the statutory State and
18 Federal income tax rates to its adjusted test year income.

19
20 **Q. Does the Company's rebuttal testimony propose a change to its direct testimony in**
21 **the amount of income tax expense to reflect changes in revenue and expenses in its**
22 **rebuttal testimony?**

23 A. Yes. The Company's rebuttal testimony proposes test year income tax expense of
24 \$10,120.³¹

³⁰ Schedule GLF-11 also shows calculations for Property Tax Expense for Staff's recommended revenue.

³¹ Bourassa Rebuttal Schedule C-2, , p. 7.

1 **Q. Did Staff also update its recommended test year income tax expense to reflect**
2 **changes in revenues and expenses in its surrebuttal testimony?**

3 A. Yes. Staff calculated test year income tax expense of \$11,904 by applying the statutory
4 State and Federal income tax rates to Staff's adjusted test year taxable income, as shown
5 in Surrebuttal Schedule GLF-2.

6
7 **Q. Since Staff and the Company used the same tax rates and methods to calculate test**
8 **year income tax expense, what accounts for the difference between the Staff and the**
9 **Company test year income tax expenses?**

10 A. Staff and the Company used different test year operating expenses and synchronized
11 interest to calculate taxable income.

12
13 **Q. What is Staff recommending?**

14 A. Staff recommends reducing test year income tax expense by \$10,969, from \$22,873 to
15 \$11,904, as shown in Surrebuttal Schedules GLF-2 and GLF-18. Staff's surrebuttal
16 recommendation is \$1,784 greater than the Company's rebuttal proposal of \$10,250.

17
18 **Q. Does Staff have any additional comments regarding income taxes?**

19 A. Yes. On Rebuttal Schedule C-3, the Company shows its calculation of a 1.7130 gross
20 revenue conversion factor. Surrebuttal Schedule GLF-2 shows the calculation of Staff's
21 1.7049 GRCF. Staff Surrebuttal Schedule GLF-2 provides a reconciliation of Staff's test
22 year and recommended revenues. The reconciliation shows the incremental operating
23 income, property tax expense and income tax expense components of Staff recommended
24 increase in revenue. The reconciliation verifies that Staff's 1.7049 GRCF results in the
25 recommended operating income.

Operating Income Adjustment No. 7 – Annualize Purchased Power Expense

Q. What did the Company propose in its application for purchased power expense?

A. Goodman proposed its recorded test year amount of \$27,066 for purchased power expense in its application.

Q. Does the Company's rebuttal testimony propose modifications to its direct testimony in regard to purchased power testing expense?

A. Yes. The Company's rebuttal testimony proposes an annualization adjustment that increases purchased power expense by \$577 to \$27,642 to recognize the additional cost to pump water due to its annualization of test year revenues.³²

Q. Is Staff in agreement with the Company's annualization adjustment for purchased power?

A. Yes. This annualization adjustment is consistent with Staff's annualization of test year revenues.

Q. What is Staff recommending?

A. Staff recommends increasing purchased power expense by \$577, from \$27,066 to \$27,642, as shown in Surrebuttal Schedule GLF-18.1. Staff's surrebuttal recommendation is the same as the Company's rebuttal proposal.

³² Bourassa Rebuttal Schedule C-2, p. 7.

IX. AFFILIATED TRANSACTIONS

Q. Does Staff have any comments regarding affiliate transactions in response to the Company's rebuttal testimony?

A. Only as stated in other sections of this testimony. E.g., in response to Mr. Shiner's rebuttal, Staff notes that it continues to advocate that the Company develop and implement written policies to guide the Company in affiliated transactions and hiring of outside consultants.

X. RATE DESIGN

Q. Does Staff have any comments regarding rate design in response to the Company's rebuttal testimony?

A. As noted by the Company, the Staff and Company rate structures are similar with the same break-over points, similar percentages of revenue recovered through the monthly minimum charges and the commodity rates.³³ Although the differences are minor, the percentages of revenue statistics used in page 42 of Mr. Bourassa's rebuttal are in error due to an incorrect formulaic cell reference in the document – Exhibit, Page 3, Goodman Water Company – Staff Proof, Revenue Breakdown Summary, Metered Revenues – Staff Proposed Rates. Also, Staff notes that the rate design presented on pages 39 and 40 of Mr. Bourassa's testimony are inconsistent with his Rebuttal Schedule H-3 with the latter being the actual rates used in his calculation of revenues.

Staff also notes that the Company's rebuttal testimony adopts Staff's recommendations for all miscellaneous charges including after-hours charges and elimination of the turn on/off charge.³⁴

³³ Bourassa rebuttal, p. 42.

³⁴ Bourassa rebuttal, p. 44.

Staff's Recommended Water Rate Design

Q. Please provide a description of Staff's surrebuttal recommended rate structure for the water system.

A. Staff recommends continuation of the fundamental existing rate structure. Staff recommends the following monthly fixed charges by customer class: 5/8 x 3/4-inch meter, \$51.00; 3/4-inch meter, \$76.50; 1-inch meter, \$128.00; 1.5-inch meter, \$255.00; 2-inch meter, \$408.00; 3-inch meter, \$816.00; 4-inch meter, \$1,275.00; and 6-inch meter, \$2,550.00. Staff recommends the following commodity rates per 1,000 gallons of water use by the 5/8 x 3/4-inch residential class, 1 to 3,000 gallons, \$4.80 per 1,000 gallons; 3,001 to 9,000 gallons, \$9.75 per 1,000 gallons; and over 9,000 gallons, \$11.75 per 1,000 gallons.

Q. Did Staff prepare schedules showing the present, Company proposed, and Staff recommended monthly minimums and commodity rates for each rate class?

A. Yes. Staff's Surrebuttal Schedule GLF-19 shows the present monthly fixed charges and commodity rates, the Company's proposed monthly fixed charges and commodity rates and Staff's recommended monthly fixed charges and commodity rates.

Q. Did Staff prepare a schedule showing the average and median monthly bill under present rates, the Company's proposed rates, and Staff's recommended rates?

A. Yes. Staff's Surrebuttal Schedule GLF-20 presents the typical bill analysis for a residential water customer using present rates, the Company's proposed rates and Staff's recommended rates.

1 **Q. What is the impact to the median customer bill with Staff's rate design?**

2 A. Staff's recommended rates would increase the typical residential water bill with median
3 month usage of 4,500 gallons by \$19.07, or 31.29 percent, from \$60.96 to \$80.03.

4
5 **Q. Will Staff's recommended rate design generate Staff's surrebuttal revenue**
6 **requirement?**

7 A. Staff's recommended rate design would generate Staff's recommended water revenue
8 requirement of \$775,283, composed of \$761,545 from water sales and \$13,738 from other
9 revenues.

10

11 **XI. STAFF'S RESPONSE TO THE REBUTTAL TESTIMONY OF THOMAS J.**
12 **BOURASSA**

13 **Q. Does Staff have any comment on Mr. Bourassa's assertion that the statement on page**
14 **10 of Mr. McMurray's direct testimony that Mr. Naifeh had a two percent interest in**
15 **D&D Investments West, LLC is inaccurate?**

16 A. Yes. Staff retracts the question and answer in Mr. McMurry's testimony on page 10, line
17 1-3. The relationship between Mr. Naifeh and Mr. Sears that results in Mr. Naifeh's lack
18 of independence is described in Mr. Naifeh's rebuttal testimony at pages 7 and 8, and it is
19 summarized above under Rate Base Adjustment No. 1 – Reduce Cost Basis for Land
20 Purchase.

1 **Q. Does Staff have any comment on Mr. Bourassa's assertion that the Commission**
2 **should authorize an accounting order relating to deferred depreciation expense for**
3 **future recovery if either Staff or RUCO recommended disallowances for excess**
4 **capacity are adopted?**³⁵

5 A Yes. The Commission should deny the Company's request for an accounting order to
6 defer depreciation expense on any plant the Commission excludes from rate base that
7 represents excess capacity. Such authorization would effectively provide impunity to the
8 Company for building excess capacity by providing an opportunity for future recovery of
9 plant that never benefitted ratepayers. Depreciation expense represents an allocation of
10 the cost of plant over its tangible life. The portion of the life that expires while the plant is
11 excess capacity cannot be recaptured at a future date, and therefore, cannot provide
12 benefits to ratepayers at a future date. Depreciation expense incurred on plant deemed
13 excess capacity should be borne by shareholders, not ratepayers.

14
15 **XII. STAFF'S RESPONSE TO THE REBUTTAL TESTIMONY OF JAMES A. SHINER**

16 **Q. Do you have any response to Mr. Shiner's rebuttal testimony?**

17 A. Yes. First, Mr. Shiner's rebuttal testimony presents a general discussion regarding
18 valuation of the land parcels, excess storage capacity and rate case expense. These issues
19 are addressed above under Rate Base Adjustment No. 1 – Reduce Cost Basis for Land
20 Purchase, Rate Base Adjustment No. 4 – Excess Capacity – Storage Tank, and Operating
21 Income Adjustment No. 2 – Rate Case Expense.

22
23 Next, Mr. Shiner states that the Company is willing to develop and implement written
24 policies of the type (affiliated transactions and hiring of outside consultants)
25 recommended by Mr. McMurry if the Commission determines they are necessary.³⁶ Staff

³⁵ Bourassa rebuttal, p. 29.

³⁶ Shiner rebuttal, p. 20.

1 continues to advocate that the Company develop and implement written policies to guide
2 the Company for these types of transactions. Written policies provide multiple benefits
3 including an opportunity to evaluate and improve existing practices, operating efficiency,
4 consistency and continuity.

5
6 **XIII. STAFF'S RESPONSE TO THE REBUTTAL TESTIMONY OF MARK TAYLOR**

7 **Q. Do you have any response to Mr. Taylor's rebuttal testimony?**

8 A. No. The issues addressed in Mr. Taylor's rebuttal testimony pertain to issues outside the
9 scope of my testimony, and those issues are addressed in the testimonies of other Staff
10 witnesses.

11
12 **XIV. STAFF'S RESPONSE TO THE REBUTTAL TESTIMONY OF MICHAEL J. NAIFEH**

13
14 **Q. Does Staff have any comments regarding Mr. Naifeh's rebuttal testimony other than**
15 **those discussed above under Rate Base Adjustment No. 1 – Reduce Cost Basis for**
16 **Land Purchase?**

17 A. Yes. First, Mr. Naifeh expressed concern that Mr. McMurry's direct testimony claims his
18 2008 appraisal was flawed.³⁷ Mr. McMurry's testimony identifies four reasons to
19 question the value that the Company used to record the land including the unintended
20 statement, "Fourth, the appraisal was flawed."³⁸ Staff retracts that portion of Mr.
21 McMurry's direct testimony, and apologizes for this oversight.

22
23 Mr., Naifeh also expressed concern that Mr. McMurry's direct testimony at page 10, line 9
24 cites Federal Deposit Insurance Corporation regulations and requirements for appraisers,

³⁷ Naifeh rebuttal, p. 11.

³⁸ McMurry direct, p. 8.

1 and he claims that those regulations are not applicable. Staff is retracting following
2 language from Mr. McMurry's testimony.

3
4 There are both appraisal guidelines and Federal Deposit Insurance
5 Corporation regulations that require that an appraiser have not interest,
6 financial or otherwise, in the property or the transaction.

7
8 **XV. STAFF'S RESPONSE TO THE REBUTTAL TESTIMONY OF JOHN**
9 **FERENCHAK III**

10 **Q. Does Staff have any comments regarding Mr. Ferenchak III's rebuttal testimony?**

11 A. Yes. Most of Staff's comments pertaining to Mr. Ferenchak III's rebuttal testimony are
12 addressed above under Rate Base Adjustment No. 1 – Reduce Cost Basis for Land
13 Purchase. That testimony notes that Staff used the 2009 Pinal County Assessor's FCV for
14 the four parcels is a reasonable place holder value. Mr. Ferenchak III's identifies the tax
15 parcel numbers for those four parcels and there respective 2010 FCVs as follows: Water
16 Plant #1 – Ptn of 305-31-013W (\$223,680); Water Plant #2 – 305-31-013Q (\$46,874);
17 Water Plant #3 – 305-93-6040 (\$500); and Water Plant #4 – 30593-219B (\$28,000).³⁹
18 Staff's direct testimony Schedule GTM-5 used a different parcel number for water plant
19 no. 1 and transcribed the parcel numbers for water plant nos. 3 and 4. Surrebuttal
20 Schedule GLF-5 corrects the transcription and uses the same parcel number (305-31-
21 013W) for water plant no. 1 as does Mr. Ferenchak III.

22
23 Also, as Mr. Ferenchak III notes in the tables in the executive summary of his appraisal,
24 dated April 29, 2011, only 31,363 square feet (0.72 acres) of the 9.32 acre parcel is
25 dedicated to water plant no. 1. Accordingly, Staff assigned a pro-rata portion $[(0.72 \div$

³⁹ Ferenchak III rebuttal, Attachment A, p.16.

1 9.32) x \$28,000 = \$2,163] of the FCV to that parcel. Further, although the 2009 FCV for
2 Water Plant #3 – 305-93-6040 is \$500, Staff used the higher value (\$28,000) pertaining
3 only to the land.
4

5 **XVI. STAFF'S RESPONSE TO THE REBUTTAL TESTIMONY OF JAMES**
6 **SCHOEMPERLEN**

7 **Q. Do you have any response to Mr. Schoemperlen's rebuttal testimony?**

8 A. Yes. Although the issues addressed in Mr. Schoemperlen's rebuttal testimony pertain to
9 issues generally outside the scope of my testimony, and those issues are addressed in the
10 testimonies of other Staff witnesses, in his discussions of these issues he discusses an
11 accounting/ratemaking concept. Specifically, Mr. Schoemperlen projects that since the
12 mix of fixed and variable costs do not remain constant with customer/revenue growth,
13 recognizing the plant values for capacity in excess of test year customers will result in
14 growth in returns.⁴⁰ Mr. Schoemperlen's observation is correct. However, the regulatory
15 framework recognizes this benefit to utilities. The regulatory framework has both
16 regulatory benefits and liabilities. Utilities are quick to draw attention to the liabilities and
17 ignore the benefits. The regulator's responsibility is to find an optimal balance between
18 the benefits and liabilities, not necessarily to eliminate them.

⁴⁰ Schoemperlen rebuttal p. 8.

**XVII. STAFF'S RESPONSE TO THE REBUTTAL TESTIMONY OF LAWRENCE
WAWRZYNIAK**

Q. What is Staff's response to Mr. Wawrzyniak's concern that Staff under reports the number of customer opinions/complaints received because petitions signed by multiple customers are counted as a single opinion/complaint?

A. Yes. Staff has revised its reported statistical data to opinions and complaints. Mr. Wawrzyniak's testimony provides a summary of opinions and complaints filed with the Commission. This appears to be raw data. Staff has found individuals and households sometimes file multiple communications, and Staff's reported communications reflect removal of multiple opinions and complaints from a single individual or household. Accordingly, Staff's reported statistics will not agree with the raw data.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.

GOODMAN WATER COMPANY

Docket No. W-02500A-10-0382

Test Year ended December 31, 2009

SURREBUTTAL TESTIMONY - GORDON L. FOX

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REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY FAIR VALUE	(C) STAFF ORIGINAL COST	(D) STAFF FAIR VALUE
1	Adjusted Rate Base	\$ 2,402,222	\$ 2,402,222	\$ 1,974,781	\$ 1,974,781
2	Adjusted Operating Income (Loss)	\$ 73,882	\$ 73,882	\$ 75,617	\$ 75,617
3	Current Rate of Return (L2 / L1)	3.08%	3.08%	3.83%	3.83%
4	Required Rate of Return	10.54%	10.54%	9.20%	9.20%
5	Required Operating Income (L4 * L1)	\$ 253,194	\$ 253,194	\$ 181,680	\$ 181,680
6	Operating Income Deficiency (L5 - L2)	\$ 179,312	\$ 179,312	\$ 106,063	\$ 106,063
7	Gross Revenue Conversion Factor	1.6254	1.6254	1.7049	1.7049
8	Required Revenue Increase (L7 * L6)	\$ 291,454	\$ 291,454	\$ 180,824	\$ 180,824
9	Adjusted Test Year Revenue	\$ 572,751	\$ 572,751	\$ 594,459	\$ 594,459
10	Proposed Annual Revenue (L8 + L9)	\$ 864,205	\$ 864,205	\$ 775,283	\$ 775,283
11	Required Increase in Revenue (%)	50.89%	50.89%	30.42%	30.42%
12	Rate of Return on Common Equity (%)	11.00%	11.00%	9.10%	9.10%

References:

Column (A): Company Schedule B-1

Column (B): Company Schedule B-1

Column (C): Company Schedules A-1, A-2, & D-1

Column (D): Staff Schedule GLF-2 , GLF-3 & GLF-11

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.0000%			
3	Revenues (L1 - L2)	100.0000%			
4	Combined Federal and State Tax Rate (Line 17) + Property Tax Factor (Line 23)	41.3448%			
5	Subtotal (L3 - L4)	58.6552%			
6	Revenue Conversion Factor (L1 / L5)	1.7049			
<u>Calculation of Uncollectible Factor:</u>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	40.7558%			
9	One Minus Combined Income Tax Rate (L7 - L8)	59.2442%			
10	Uncollectible Rate	0.0000%			
11	Uncollectible Factor (L9 * L10)	0			
<u>Calculation of Effective Tax Rate:</u>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	6.9680%			
14	Federal Taxable Income (L12 - L13)	93.0320%			
15	Applicable Federal Income Tax Rate (Line 53)	36.3185%			
16	Effective Federal Income Tax Rate (L14 x L15)	0.33787801			
17	Combined Federal and State Income Tax Rate (L13 + L16)	40.7558%			
<u>Calculation of Effective Property Tax Factor</u>					
18	Unity	100.0000%			
19	Combined Federal and State Tax Rate (Line 17)	40.7558%			
20	One Minus Combined Income Tax Rate (L18 - L19)	59.2442%			
21	Property Tax Factor (GLF-17, L26)	0.9941%			
22	Effective Property Tax Factor (L 21 * L 22)	0.5890%			
23	Combined Federal and State Tax and Property Tax Rate (L17+L22)		41.3448%		
24	Required Operating Income (Schedule GLF-1, Line 5)	\$ 181,680			
25	Adjusted Test Year Operating Income (Loss) (Schedule GLF-11, Line 33)	\$ 75,617			
26	Required Increase in Operating Income (L24 - L25)		\$ 106,063		
27	Income Taxes on Recommended Revenue (Col. (D), L52)	\$ 84,867			
28	Income Taxes on Test Year Revenue (Col. (B), L52)	\$ 11,904			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		\$ 72,964		
30	Recommended Revenue Requirement (Schedule GLF-1, Line 10)	\$ 775,283			
31	Uncollectible Rate (Line 10)	0.0000%			
32	Uncollectible Expense on Recommended Revenue (L24 * L25)	\$ -			
33	Adjusted Test Year Uncollectible Expense	\$ -			
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32 - L33)		\$ -		
35	Property Tax with Recommended Revenue (GLF-17, L21)	\$ 20,846			
36	Property Tax on Test Year Revenue (GLF-17, L22)	\$ 19,049			
37	Increase in Property Tax Due to Increase in Revenue (GLF-17, L23)		\$ 1,798		
38	Total Required Increase in Revenue (L26 + L29 + L34+L37)		\$ 180,824		
<u>Calculation of Income Tax:</u>					
39	Revenue (Schedule GLF-11, Col.[C], Line 5 & Sch. GLF-1, Col. [D], Line 10)	\$ 594,459			
40	Operating Expenses Excluding Income Taxes	\$ 506,938			
41	Synchronized Interest (L56)	\$ 31,596			
42	Arizona Taxable Income (L39 - L40- L41)	\$ 55,924			
43	Arizona State Income Tax Rate	6.9680%			
44	Arizona Income Tax (L42 x L43)		\$ 3,897		\$ 16,371
45	Federal Taxable Income (L42 - L44)	\$ 52,028			
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ 7,500			
47	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	\$ 507			
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -			
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -			
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -			
51	Total Federal Income Tax		\$ 8,007		\$ 68,496
52	Combined Federal and State Income Tax (L44 + L51)		\$ 11,904		\$ 84,867
53	Applicable Federal Income Tax Rate [Col. (D), L51 - Col. (B), L51] / [Col. (C), L44 - Col. (A), L44]				36.32%
<u>Calculation of Interest Synchronization:</u>					
54	Rate Base (Schedule GLF-3, Col. [C], Line (14))	\$ 1,974,781			
55	Weighted Average Cost of Debt (Surrebuttal Schedule JCM-1)	1.60%			
56	Synchronized Interest (L54 X L55)	\$ 31,596			

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Surrebuttal Schedule GLF-3

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	REF	(C) STAFF AS ADJUSTED
1	Plant in Service	\$ 5,453,761	\$ (580,787)	\$ 4,872,974
2	Less: Accumulated Depreciation	731,205	(7,910)	723,295
3	Net Plant in Service	<u>\$ 4,722,556</u>	<u>\$ (572,877)</u>	<u>\$ 4,149,679</u>
<u>LESS:</u>				
4	Contributions in Aid of Construction (CIAC)	\$ -	\$ -	\$ -
5	Less: Accumulated Amortization	-	-	-
6	Net CIAC	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
7	Advances in Aid of Construction (AIAC)	2,101,905	(128,600)	1,973,305
8	Service Line & Meter Installation Charges	83,087	-	83,087
9	Deferred Income Tax Credits	135,342	(16,836)	118,506
<u>ADD:</u>				
10	Unamortized Finance Charges	-	-	-
11	Deferred Tax Assets	-	-	-
12	Working Capital	-	-	-
13	Intentionally Left Blank	-	-	-
14	Original Cost Rate Base	<u>\$ 2,402,222</u>	<u>\$ (427,441)</u>	<u>\$ 1,974,781</u>

References:

Column (A), Company Schedule B-1
Column [B]: Column [C] - Column [A]
Column [C], GLF-4

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	ACCT. NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] LAND ADJ.#1	[C] WATER TREATMENT ADJ.#2	[D] DISTRIBUTION RESERVOIR ADJ.#3	[E] DISTRIBUTION RESERVOIR ADJ.#4	[F] TRANSMISSION MAINS ADJ.#5	[G] DEPRECIATION ADJ.#6	[C] AIAC ADJ.#7	[I] ADIT ADJ.#8	[J] STAFF ADJUSTED
PLANT IN SERVICE:												
1	301	Organization Cost	\$ 127,103	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 127,103
2	302	Franchise Cost	-	-	-	-	-	-	-	-	-	-
3	303	Land and Land Rights	494,159	(379,837)	-	-	-	-	-	-	-	114,322
4	304	Structures and Improvements	182,570	-	-	-	-	-	-	-	-	182,570
5	305	Collecting and Impounding Res.	-	-	-	-	-	-	-	-	-	-
6	306	Lake River and other Intakes	-	-	-	-	-	-	-	-	-	-
7	307	Wells and Springs	386,591	-	-	-	-	-	-	-	-	386,591
8	308	Infiltration Galleries and Tunnels	-	-	-	-	-	-	-	-	-	-
9	309	Supply Mains	-	-	-	-	-	-	-	-	-	-
10	310	Power Generation Equipment	968,652	-	-	-	-	-	-	-	-	968,652
11	311	Electrical Pumping Equipment	15,947	-	(15,947)	-	-	-	-	-	-	-
12	320	Water Treatment Plant	-	-	15,947	-	-	-	-	-	-	-
13	320.1	Chemical Solution Feeders	-	-	-	-	-	-	-	-	-	-
14	320.2	Distribution Reservoirs & Standpipe	836,890	-	-	(836,890)	(72,350)	-	-	-	-	15,947
15	330	Storage Tanks	-	-	-	384,827	-	-	-	-	-	312,477
16	330.1	Pressure Tanks	-	-	-	452,063	-	-	-	-	-	452,063
17	330.2	Transmission and Distribution Mains	1,611,320	-	-	-	-	(128,600)	-	-	-	1,482,720
18	331	Services	386,947	-	-	-	-	-	-	-	-	386,947
19	333	Hydrants	94,263	-	-	-	-	-	-	-	-	94,263
20	334	Meters	161,737	-	-	-	-	-	-	-	-	161,737
21	335	Backflow Prevention Devices	-	-	-	-	-	-	-	-	-	-
22	336	Other Plant & Miscellaneous Equipment	187,582	-	-	-	-	-	-	-	-	187,582
23	339	Office Furniture & Fixtures	-	-	-	-	-	-	-	-	-	-
24	340	Computers & Software	-	-	-	-	-	-	-	-	-	-
25	340.1	Transportation Equipment	-	-	-	-	-	-	-	-	-	-
26	341	Stores Equipment	-	-	-	-	-	-	-	-	-	-
27	342	Tools and Work Equipment	-	-	-	-	-	-	-	-	-	-
28	343	Laboratory Equipment	-	-	-	-	-	-	-	-	-	-
29	344	Power Operated Equipment	-	-	-	-	-	-	-	-	-	-
30	345	Communications Equipment	-	-	-	-	-	-	-	-	-	-
31	346	Miscellaneous Equipment	-	-	-	-	-	-	-	-	-	-
32	347	Other Tangible Plant	-	-	-	-	-	-	-	-	-	-
33	348	Rounding Amount	-	-	-	-	-	-	-	-	-	-
34		Subtotal Plant in Service	\$ 5,453,761	\$ (379,837)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ -	\$ -	\$ -	\$ 4,872,974
35												
36		Add:										
37	Other 1	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
38	Other 2	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
39	Less:											
40	Other 3	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
41	Other 4	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
42												
43	Total Plant in Service:		\$ 5,453,761	\$ (379,837)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ (7,910)	\$ -	\$ -	\$ 4,872,974
44	Less: Accumulated Depreciation		731,205	-	-	-	-	-	-	-	-	\$ 723,295
45	Intentionally Left Blank		-	-	-	-	-	-	-	-	-	-
46	Net Plant in Service (L59 - L 60)		\$ 4,722,556	\$ (379,837)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ 7,910	\$ -	\$ -	\$ 4,149,879
47												
48	LESS:											
49	Contributions in Aid of Construction (CIAC)		-	-	-	-	-	-	-	-	-	-
50	Less: Accumulated Amortization		-	-	-	-	-	-	-	-	-	-
51	Net CIAC (L49 - L50)		-	-	-	-	-	-	-	-	-	-
52	Advances in Aid of Construction (AIAC)		2,101,905	-	-	-	-	-	-	(128,600)	-	1,973,305
53	Service Line & Meter Installation Charges		83,087	-	-	-	-	-	-	-	(16,836)	83,087
54	Deferred Income Tax Credit		135,342	-	-	-	-	-	-	-	-	118,506
55												
56	ADD:											
57	Unamortized Finance Charges		-	-	-	-	-	-	-	-	-	-
58	Deferred Tax Assets		-	-	-	-	-	-	-	-	-	-
59	Working Capital		-	-	-	-	-	-	-	-	-	-
60	Regulatory Asset (Liability)		-	-	-	-	-	-	-	-	-	-
61	Original Cost Rate Base		\$ 2,402,222	\$ (379,837)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ 7,910	\$ 128,600	\$ 16,836	\$ 1,974,781

References:
Column [A] Schedule B-2, E-1

ORIGINAL COST RATE BASE ADJUSTMENT # 1 - REDUCE COST BASIS FOR LAND PURCHASE

Line No.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	303	Land and Land Rights	\$ 494,159	\$ (379,837)	\$ 114,322

	Accessor's Parcel No.	Acres	Full Cash Value 2009 ¹	Market Value Opinion ²
2				
3	305-31-013 W (Plant No. 1)	0.72	\$ 2,163 ⁴	\$ 180,000 ³
5	305-31-013 Q (Plant No. 2)	0.25	40,000	60,000
6	305-93-6040 (Plant No. 3)	0.63	40,000	150,000
7	305-93-219 B (Plant No. 4)	0.39	28,000	100,000
8				
9		1.99	\$ 110,163	\$ 490,000

- (1) - This is the full cash value (FCV) for 2009 as obtained from the Pinal County Assessor's website.
(2) - The Company provided a six page "A Summary Appraisal Report developing market value opinions of the underlying land (a fractional interest appraisal)" by M. Naifeh, MAI, CRE.
(3) - Parcel "one" is comprised of two real estate parcels.
(4) - 0.72 acres / 9.32 acres x \$28,000 = \$2,163

Staff's basis for Land

Assesor's FCV - Plant No. 1 calculated	\$ 110,163
Closing Costs	2,159
Appraisal Fee	2,000
	<u>\$ 114,322</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

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Surrebuttal Schedule GLF-6

ORIGINAL COST RATE BASE ADJUSTMENT # 2 - RECLASSIFY WATER TREATMENT EQUIPMENT

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	320	Water Treatment Equipment	\$ 15,947	\$ (15,947)	\$ -
2	320.1	Water Treatment Plant		-	-
3	320.2	Chemical Solution Feeders		\$ 15,947	\$ 15,947
4		Total	<u>\$ 15,947</u>	<u>\$ -</u>	<u>\$ 15,947</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony , SDR GTM-1.5
Col [C]: Col. [A] + Col. [B]

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Surrebuttal Schedule GLF-7

ORIGINAL COST RATE BASE ADJUSTMENT # 3 - RECLASSIFY DISTRIBUTION RESERVOIRS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	330	Distribution Reservoirs & Standpipe	\$ 836,890	\$ (836,890)	\$ -
2	330.1	Storage Tanks		\$ 384,827	\$ 384,827
3	330.2	Pressure Tanks		\$ 452,063	\$ 452,063
4		Total	<u>\$ 836,890</u>	<u>\$ -</u>	<u>\$ 836,890</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony, SDR GTM-1.4

Col [C]: Col. [A] + Col. [B]

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Surrebuttal Schedule GLF-8

ORIGINAL COST RATE BASE ADJUSTMENT # 4 - ELIMINATE EXCESS CAPACITY - STORAGE TANK

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	331	Storage Tanks ¹	\$ 384,827	\$ (72,350)	\$ 312,477

¹ The Company proposed amount is the portion claimed by the Company and reclassified by Staff to Acct. 330.1 as shown in GTM-7.

References:

Col [A]: Company Schedule B-1
Col [B]: GLF and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

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Surrebuttal Schedule GLF-9

ORIGINAL COST RATE BASE ADJUSTMENT # 5 - ELIMINATE EXCESS CAPACITY - DISTRIBUTION MAINS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	333	Transmission and Distribution Mains	<u>1,611,320</u>	<u>\$ (128,600)</u>	<u>\$ 1,482,720</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

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Surrebuttal Schedule GLF-10

ORIGINAL COST RATE BASE ADJUSTMENT # 6 - ADJUST ACCUMULATED DEPRECIATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Depreciation	\$ 731,205	\$ (7,910)	\$ 723,295
			Accumulated Depreciation per application	Accumulated Depreciation per Staff	Difference
2		Structures and Improvements	\$ 10,285	\$ 10,285	\$ 0
3		Collecting and Impounding Res.	-	-	-
4		Lake River and other Intakes	-	-	-
5		Wells and Springs	67,423	67,423	0
6		Infiltration Galleries and Tunnels	-	-	-
7		Supply Mains	-	-	-
8		Power Generation Equipment	-	-	-
9		Electrical Pumping Equipment	341,101	341,101	0
10		Water Treatment Equipment	2,167	0	(2,167)
11		Water Treatment Plant	-	-	-
12		Chemical Solution Feeders	-	2,167	2,167
13		Distribution Reservoirs & Standpipe	64,318	-	(64,318)
14		Storage Tanks	-	27,712	27,712
15		Pressure Tanks	-	32,553	32,553
16		Transmission and Distribution Mains	139,059	135,201	(3,858)
17		Services	40,947	40,947	-
18		Meters	17,066	17,066	-
19		Hydrants	12,984	12,984	-
20		Backflow Prevention Devices	-	-	-
21		Other Plant & Miscellaneous Equipment	35,847	35,847	-
22		Office Furniture & Fixtures	-	-	-
23		Computers & Software	-	-	-
24		Transportation Equipment	-	-	-
25		Stores Equipment	-	-	-
26		Tools and Work Equipment	-	-	-
27		Laboratory Equipment	-	-	-
28		Power Operated Equipment	-	-	-
29		Communications Equipment	-	-	-
30		Miscellaneous Equipment	-	-	-
31		Other Tangible Plant	-	-	-
			\$ 731,197	\$ 723,287	\$ (7,910)

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony, RUCO DR 2.12
Col [C]: Col. [A] + Col. [B]

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Surrebuttal Schedule GLF-10.1

ORIGINAL COST RATE BASE ADJUSTMENT # 7 - REDUCE AIAC

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	108	Accumulated Depreciation	<u>2,101,905</u>	<u>\$ (128,600)</u>	<u>\$ 1,973,305</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

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Surrebuttal Schedule GLF-10.2

ORIGINAL COST RATE BASE ADJUSTMENT # 8 - ACCUMULATED DEFERRED INCOME TAX

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Deferred Income Tax	<u>135,342</u>	<u>\$ (16,836)</u>	<u>\$ 118,506</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

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OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

LINE NO.	DESCRIPTION	[A] COMPANY ADJUSTED TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
1	<u>OPERATING REVENUES:</u>					
2	Metered Water Revenues	\$ 559,013	\$ 21,708	\$ 580,721	\$ 180,824	\$ 761,545
3	Unmetered Water Revenues	-	-	-	-	-
4	Other Water Revenues	13,738	-	13,738	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ 594,459	\$ 180,824	\$ 775,283
6	<u>OPERATING EXPENSES:</u>					
7	Salaries and Wages	\$ 40,000	-	\$ 40,000	\$ -	\$ 40,000
8	Employee Pensions & Benefits	-	-	-	-	-
9	Purchased Water	-	-	-	-	-
10	Purchased Power	27,066	577	27,643	-	27,643
11	Chemicals	-	-	-	-	-
12	Repairs and Maintenance	7,746	-	7,746	-	7,746
13	Office Supplies and Expense	14,855	-	14,855	-	14,855
14	Outside Services	102,925	-	102,925	-	102,925
15	Water Testing	1,215	1,568	2,783	-	2,783
16	Rents	-	-	-	-	-
17	Transportation Expenses	-	-	-	-	-
18	Insurance - General Liability	9,669	-	9,669	-	9,669
19	Insurance - Health and Life	-	-	-	-	-
20	Advertising	-	-	-	-	-
21	Regulatory Comm Expense - Rate Case	20,000	20,000	40,000	-	40,000
22	Regulatory Comm Expense - Other	378	-	378	-	378
23	Bad Debt Expense	-	-	-	-	-
24	Miscellaneous Expense	-	-	-	-	-
25	Depreciation and Amortization	227,855	11,047	238,902	-	238,902
26	Interest on Security Deposits	-	-	-	-	-
27	Taxes other than Income	2,988	-	2,988	-	2,988
28	Property Taxes	21,299	(2,250)	19,049	1,798	20,846
29	Income Tax	22,873	(10,969)	11,904	72,964	84,867
30	Total Operating Expenses	\$ 498,869	\$ 19,973	\$ 518,842	\$ 74,761	\$ 593,603
31	Operating Income	\$ 73,882	\$ 1,735	\$ 75,617	\$ 106,063	\$ 181,680
32						
33						

References:

Column [A]: Company Schedule C-1
Column [B]: Schedule GLF-12
Column [C]: Column [A] + Column [B]
Column [D]: Schedules GLF-1 and GLF-2
Column [E]: Column [C] + Column [D]

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) GLF-13 Revenue Annualization ADJ #1	(C) GLF-14 Rate Case Exp ADJ #2	(D) GLF-15 Water Testing ADJ #3	(E) GLF-16 Depreciation Exp ADJ #4	(F) GLF-17 Property Taxes ADJ #5	(G) GLF-18 Income Taxes ADJ #6	(H) GLF-18.1 An Pur Pwr ADJ #7	(I) STAFF ADJUSTED
1	<u>Operating Revenues:</u>									
2	Metered Water Revenues	\$ 559,013	\$ 21,708							\$ 580,721
3	Unmetered Water Revenues	13,738								13,738
4	Other Water Revenues									
5	Total Operating Revenues	\$ 572,751	\$ 21,708							\$ 594,459
6	<u>Operating Expenses:</u>									
7	Salaries and Wages	\$ 40,000								40,000
8	Employee Pensions & Benefits									
9	Purchased Water								577	27,643
10	Purchased Power	27,066								
11	Chemicals									7,746
12	Repairs and Maintenance	7,746								14,855
13	Office Supplies and Expense	14,855								102,925
14	Outside Services	102,925								2,763
15	Water Testing	1,215			1,568					
16	Rents									
17	Transportation Expenses									9,669
18	Insurance - General Liability	9,669								
19	Insurance - Health and Life									
20	Advertising									40,000
21	Regulatory Comm Expense - Rate Case	20,000		20,000						378
22	Regulatory Comm Expense - Other	378								
23	Bad Debt Expense									
24	Miscellaneous Expense	227,855				11,047				238,902
25	Depreciation and Amortization									2,988
26	Interest on Security Deposits	2,988								19,049
27	Taxes other than Income	21,299					(2,250)			11,904
28	Property Taxes	22,873						(10,969)		
29	Income Tax	498,869		20,000	1,568	11,047	(2,250)	(10,969)	577	518,842
30	Total Operating Expenses	\$ 73,882	\$ 21,708	\$ (20,000)	\$ (1,568)	\$ (11,047)	\$ 2,250	\$ 10,969	\$ (577)	\$ 75,617
31	Operating Income									

References:
Column (A): Company Schedule C-1
Column (B) - (G): Schedule GTW-13 through GTW-17
Column (I): Add Column (A) - Column (F)

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Surrebuttal Schedule GLF-13

OPERATING INCOME ADJUSTMENT # 1 - REVENUE ANNUALIZATION

<u>LINE</u> <u>NO.</u>	<u>Account</u> <u>Number</u>	<u>DESCRIPTION</u>	<u>[A]</u> <u>COMPANY</u> <u>PROPOSED</u>	<u>[B]</u> <u>STAFF</u> <u>ADJUSTMENTS</u>	<u>[C]</u> <u>STAFF</u> <u>RECOMMENDED</u>
1		Metered Water Revenues	<u>\$ 559,013</u>	<u>\$ 21,708</u>	<u>\$ 580,721</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Surrebuttal Schedule GLF-14

OPERATING INCOME ADJUSTMENT # 2 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Regulatory Commission Expense - Rate Case	\$ 20,000	\$ 20,000	\$ 40,000

References:

Column [A]: Company Schedule C-1

Column [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Surrebuttal Schedule GLF-15

OPERATING INCOME ADJUSTMENT # 3 - WATER TESTING EXPENSE

<u>LINE NO.</u>	<u>Account Number</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1		Water Testing	<u>\$ 1,215</u>	<u>\$ 1,568</u>	<u>\$ 2,783</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Surrebuttal Schedule GLF-16

OPERATING INCOME ADJUSTMENT # 4 - DEPRECIATION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Depreciation and Amortization	\$ 227,855	\$ 11,047	\$ 238,902

Line No.	ACCT NO.	DESCRIPTION	[A] Company Proposed PLANT IN SERVICE BALANCE	[B] STAFF DEPR. PLANT BALANCE	[C] STAFF RECOMMENDED RATE	[D] STAFF RECOMMENDED EXPENSE
		Plant In Service				
2	301	Organization Cost	\$ 127,103	127,103	0.00%	\$ -
3	302	Franchise Cost	-	-	0.00%	-
4	303	Land and Land Rights	494,159	114,322	0.00%	-
5	304	Structures and Improvements	182,570	182,570	3.33%	6,080
6	305	Collecting and Impounding Res.	-	-	2.50%	-
7	306	Lake River and other Intakes	-	-	2.50%	-
8	307	Wells and Springs	386,591	386,591	3.33%	12,873
9	308	Infiltration Galleries and Tunnels	-	-	6.67%	-
10	309	Supply Mains	-	-	2.00%	-
11	310	Power Generation Equipment	-	-	5.00%	-
12	311	Electrical Pumping Equipment	968,652	968,652	12.50%	121,082
13	320.0	Water Treatment Equipment	15,947	-	-	-
14	320.1	Water Treatment Plant	-	-	3.33%	-
15	320.2	Chemical Solution Feeders	-	15,947	20.00%	3,189
16	330	Distribution Reservoirs & Standpipe	836,890	-	-	-
17	330	Storage Tanks	-	312,477	2.22%	6,937
18	330	Pressure Tanks	-	452,063	5.00%	22,603
19	331	Transmission and Distribution Mains	1,611,320	1,482,720	2.00%	29,654
20	333	Services	386,947	386,947	3.33%	12,885
21	334	Meters	94,263	94,263	8.33%	7,852
22	335	Hydrants	161,737	161,737	2.00%	3,235
23	336	Backflow Prevention Devices	-	-	6.67%	-
24	339	Other Plant & Miscellaneous Equipment	187,582	187,582	6.67%	12,512
25	340	Office Furniture & Fixtures	-	-	6.67%	-
26	340	Computers & Software	-	-	20.00%	-
27	341	Transportation Equipment	-	-	20.00%	-
28	342	Stores Equipment	-	-	4.00%	-
29	343	Tools and Work Equipment	-	-	5.00%	-
30	344	Laboratory Equipment	-	-	10.00%	-
31	345	Power Operated Equipment	-	-	5.00%	-
32	346	Communications Equipment	-	-	10.00%	-
33	347	Miscellaneous Equipment	-	-	10.00%	-
34	348	Other Tangible Plant	-	-	3.33%	-
35	-	Rounding Amount	-	-	67.00%	-
36		Subtotal General	\$ 5,453,761	\$ 4,872,974		\$ 238,902
37		Less: Non- depreciable Account(s)	621,262	241,425		
38		Depreciable Plant (L29-L30)	\$ 4,832,499	\$ 4,631,549		
39		Contributions-in-Aid-of-Construction (CIAC)			\$ -	
40		Weighted Average Depreciation/Amortization Rate			5.1582%	
41		Less: Amortization of CIAC (L32 x L33)				\$ -
42		Depreciation Expense - STAFF [Col. (C), L36 - L41]				\$ 238,902

OPERATING INCOME ADJUSTMENT # 5 - PROPERTY TAXES

LINE NO.	Property Tax Calculation	[A]		[B]	
		STAFF AS ADJUSTED		STAFF RECOMMENDED	
1	Staff Adjusted Test Year Revenues - 2009	\$	594,459	\$	594,459
2	Weight Factor		2		2
3	Subtotal (Line 1 * Line 2)	\$	1,188,918	\$	1,188,918
4a	Staff Adjusted Test Year Revenues - 2006		594,459		
4b	Staff Recommended Revenue, Per Schedule GLF-1				775,283
5	Subtotal (Line 4 + Line 5)	\$	1,783,377	\$	1,964,201
6	Number of Years		3		3
7	Three Year Average (Line 5 / Line 6)	\$	594,459	\$	654,734
8	Department of Revenue Multiplier		2		2
9	Revenue Base Value (Line 7 * Line 8)	\$	1,188,918	\$	1,309,467
10	Plus: 10% of CWIP -				-
11	Less: Net Book Value of Licensed Vehicles				-
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$	1,188,918	\$	1,309,467
13	Assessment Ratio		20.0%		20.0%
14	Assessment Value (Line 12 * Line 13)		237,784	\$	261,893
15	Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16)		7.4558%		7.4558%
16	Property Tax Expense - Excludes Parcels (Line 14 * Line 15)	\$	17,729	\$	19,526
17	Tax of Parcels	\$	1,320	\$	1,320
18	Staff Recommended Test Year Property Tax (Line 16 + Line 17)	\$	19,049		
19	Company Proposed Property Tax		21,299		
20	Staff Test Year Adjustment (Line 18-Line 19)	\$	(2,250)		
21	Property Tax - Staff Recommended Revenue (Line 16 + Line 17)			\$	20,846
22	Staff Test Year Adjusted Property Tax Expense (Line 18)			\$	19,049
23	Increase/(Decrease) to Property Tax Expense Line 21 - Line 22)			\$	1,798
24	Increase to Property Tax Expense			\$	1,798
25	Increase in Revenue Requirement				180,824
26	Increase to Property Tax per Dollar Increase in Revenue (Line 24/Line 25)				0.994107%

References:

Col [A]: Company Schedule C-1 Page 3
Col [B]: GLF Testimony

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Surrebuttal Schedule GLF-18

OPERATING INCOME ADJUSTMENT # 6 - INCOME TAXES

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Income Tax	\$ 22,873	\$ (10,969)	\$ 11,904
2				
3				
4				
5				
6				
7				
8				
9				
10				
11	<u>References:</u>			
12	Col [A]: Company Schedule C-1 Page 3			
13	Col [B]: Column [C] - Column [A]			
14	Col [C]: Schedule GLF-2			

GOODMAN WATER COMPANY

Docket No. W-02500A-10-0382

Test Year ended December 31, 2009

Surrebuttal Schedule GLF-18.1

OPERATING INCOME ADJUSTMENT # 7 - ANNUALIZE PURCHASED POWER

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Purchased Power	<u>\$ 27,066</u>	<u>\$ 577</u>	<u>\$ 27,643</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

RATE DESIGN

Monthly Usage Charge (all classes)	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" Meter - All Classes	\$ 42.20	\$ 56.97	\$ 51.00
3/4" Meter - All Classes	\$ 63.30	\$ 85.46	\$ 76.50
1" Meter - All Classes	\$ 105.50	\$ 142.43	\$ 128.00
1½" Meter - All Classes	\$ 211.50	\$ 284.85	\$ 255.00
2" Meter - All Classes	\$ 339.68	\$ 455.76	\$ 408.00
3" Meter - All Classes	\$ 675.20	\$ 911.52	\$ 816.00
4" Meter - All Classes	\$ 1,055.00	\$ 1,424.25	\$ 1,275.00
6" Meter - All Classes	\$ 2,110.00	\$ 2,848.50	\$ 2,550.00
Construction/Stand pipe	N/A	N/A	N/A
Commodity Rates (all classes)			
5/8" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.80
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 9,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
3/4" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.80
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 10,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
1" Meter			
From 1 to 22,500 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 22,500 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
1½" Meter			
From 1 to 34,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 34,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
2" Meter			
From 1 to 45,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 45,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
3" Meter			
From 1 to 68,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 68,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
4" Meter			
From 1 to 90,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 90,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
6" Meter (Res., Comm.)			
From 1 to 135,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.75
Over 135,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.75
Construction/Stand pipe (Res., Comm.)			
All Gallons	\$ 7.11	\$ 13.13	\$ 11.75

	Present	Co. Proposed			Staff Recommended		
Service Line and Meter Installation Charges	Total	Line	Meter	Total	Line	Meter	Total
5/8" Meter	\$ 225	\$ 385	\$ 135	\$ 520	\$ 385	\$ 135	\$ 520
3/4" Meter	270	415	205	620	415	205	620
1" Meter	300	465	265	730	465	265	730
1½" Meter	425	520	475	995	520	475	995
2" Turbine Meter	550	800	995	1,795	800	995	1,795
2" Compound Meter	550	800	1,840	2,640	800	1,840	2,640
3" Turbine Meter	750	1,015	1,620	2,635	1,015	1,620	2,635
3" Compound Meter	750	1,135	2,495	3,630	1,135	2,495	3,630
4" Turbine Meter	1,375	1,430	2,570	4,000	1,430	2,570	4,000
4" Compound Meter	1,375	1,610	3,545	5,155	1,610	3,545	5,155
6" Turbine Meter	2,800	2,150	4,925	7,075	2,150	4,925	7,075
6" Compound Meter	2,800	2,270	6,820	9,090	2,270	6,820	9,090
8"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
10"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
12"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
Service Charges							
Establishment	\$ 50.00			\$ 50.00			\$ 50.00
Establishment (After Hours)	75.00			75.00			NT
Reconnection (delinquent)	75.00			75.00			75.00
Reconnection (after hours)	50.00			50.00			NT
Meter Test	20.00			20.00			20.00
Deposit Requirement (Residential)	(a)			(a)			(a)
Deposit Requirement (None Residential Meter)	(a)			(a)			(a)
Deposit Interest	6.00%			6.00%			6.00%
Re-Establishment (With-in 12 Months)	(b)			(b)			(b)
NSF Check	15.00			15.00			15.00
Deferred Payment, Per Month	1.5%			1.50%			1.50%
Meter Re-Read	20.00			20.00			20.00
Late Charge per month	1.5%			1.5%			1.5%
Customer Requested Meter Test	20.00			20.00			20.00
After Hours Service Charge	10.00			10.00			50.00
Turn-on/off (at customer request)	NT			75.00			NT
Moving Customer Meter (at customer request)	NT			cost			cost
NT = No Tariff							
Monthly Service Charge for Fire Sprinkler							
All Meter Sizes					Greater of \$10 or 2 percent of the general service rate for a similar size meter.		

Per Commission Rules (R14-2-403.B)

- (a) Residential - two times the average bill. Non-residential - two and one-half times the average bill.
(b) Minimum charge times number of months disconnected.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission Rule (14-2-409.D.5).
All advances and/or contributions are to include labor, materials, overheads and all applicable taxes,
Cost to include labor, materials and parts, overheads and all applicable taxes.

Typical Bill Analysis
Residential 5/8 Inch Meter

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	5,477	\$ 66.73	\$ 100.30	\$ 33.57	50.31%
Median Usage	4,500	60.96	89.63	\$ 28.68	47.04%

Staff Recommended

Average Usage	5,477	\$ 66.73	\$ 89.55	\$ 22.82	34.20%
Median Usage	4,500	60.96	80.03	\$ 19.07	31.29%

Present & Proposed Rates (Without Taxes)
Residential 5/8 Inch Meter

Consumption	Rates	Rates	Increase	Rates	Increase
-	\$ 42.20	\$ 56.97	35.00%	\$ 51.00	20.85%
1,000	46.15	63.77	38.18%	55.80	20.91%
2,000	50.10	70.57	40.86%	60.60	20.96%
3,000	54.05	77.37	43.15%	65.40	21.00%
4,000	58.00	84.17	45.12%	75.15	29.57%
4,500	60.96	89.63	47.04%	80.03	31.29%
5,000	63.91	95.09	48.79%	84.90	32.84%
5,477	66.73	100.30	50.31%	89.55	34.20%
6,000	69.82	106.01	51.83%	94.65	35.56%
7,000	75.73	116.93	54.40%	104.40	37.86%
8,000	81.64	127.85	56.60%	114.15	39.82%
9,000	87.55	138.77	58.50%	123.90	41.52%
10,000	94.66	151.90	60.47%	135.65	43.30%
11,000	101.77	165.03	62.16%	147.40	44.84%
12,000	108.88	178.16	63.63%	159.15	46.17%
13,000	115.99	191.29	64.92%	170.90	47.34%
14,000	123.10	204.42	66.06%	182.65	48.38%
15,000	130.21	217.55	67.08%	194.40	49.30%
16,000	137.32	230.68	67.99%	206.15	50.12%
17,000	144.43	243.81	68.81%	217.90	50.87%
18,000	151.54	256.94	69.55%	229.65	51.54%
19,000	158.65	270.07	70.23%	241.40	52.16%
20,000	165.76	283.20	70.85%	253.15	52.72%
25,000	201.31	348.85	73.29%	311.90	54.94%
30,000	236.86	414.50	75.00%	370.65	56.48%
35,000	272.41	480.15	76.26%	429.40	57.63%
40,000	307.96	545.80	77.23%	488.15	58.51%
45,000	343.51	611.45	78.00%	546.90	59.21%
50,000	379.06	677.10	78.63%	605.65	59.78%
75,000	556.81	1,005.35	80.56%	899.40	61.53%
100,000	734.56	1,333.60	81.55%	1,193.15	62.43%

MEMORANDUM

RECEIVED

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

RECEIVED

2011 OCT 24 P 3:18

OCT 24 2011

AZ CORP COMMISSION
DOCKET CONTROL

DATE: October 24, 2011

LEGAL DIV.
ARIZ. CORPORATION COMMISSION

RE: SUPPLEMENTAL STAFF REPORT FOR GOODMAN WATER COMPANY'S
APPLICATION FOR A RATE INCREASE. DOCKET NO. W-2500A-10-0382

Attached is the Supplemental Staff Report for Goodman Water Company's application for a permanent increase in rates pursuant to a Procedural Order dated September 15, 2011, to provide by October 24, 2011, any comments in opposition to the settlement agreement entered in by some of the parties in this rate case. Staff opposes the settlement agreement, as filed, and recommends adoption Staff's modifications to the Settlement Agreement.

SMO:GLF:red

Originator: Gordon L. Fox

Attachment: Original and fifteen copies

FILE COPY



**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

GOODMAN WATER COMPANY

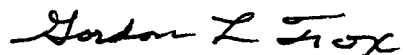
DOCKET NO. W-2500A-10-0382

**APPLICATION
FOR A RATE INCREASE**

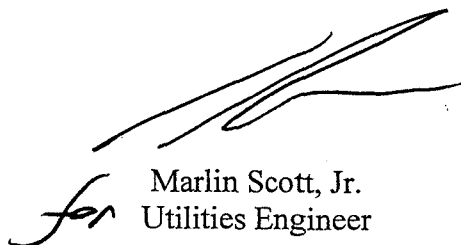
OCTOBER 24, 2011

STAFF ACKNOWLEDGMENT

The Supplemental Staff Report for Goodman Water Company Docket No. W-2500A-10-0382 is the responsibility of the Staff members listed below. Gordon L. Fox is responsible for the financial analysis. Marlin Scott, Jr. is responsible for the engineering and technical analysis.



Gordon L. Fox
Public Utility Analyst Manager


for

Marlin Scott, Jr.
Utilities Engineer

TABLE OF CONTENTS

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SETTLEMENT AGREEMENT	2
ENGINEERING ANALYSIS.....	3
FINANCIAL ANALYSIS	4
STAFF RECOMMENDATIONS.....	7

SCHEDULES

STAFF UPDATED (9/12/11) SURREBUTTAL RECOMMENDATION	GLF-1 through 20
PHASE I RATES.....	GLF-1 through 20
PHASE 2 RATES	GLF-1 through 20
PHASE 3 RATES	GLF-1 through 20

SUMMARY OF FILING/BACKGROUND

On September 10, 2010, Goodman Water Company (“Goodman” or “Company”), an Arizona for-profit, Class C public service corporation providing water service to approximately 600 customers in the vicinity of Oracle in Pinal County, Arizona, filed an application for a permanent rate increase with the Arizona Corporation Commission (“Commission”). Goodman’s application, as filed, requests a \$291,454 (50.9 percent) revenue increase to provide a \$253,194 operating income for a 10.54 percent rate of return on a \$2,402,222 fair value rate base (“FVRB”).¹ Goodman’s Rebuttal testimony requests a 262,717 (44.19 percent) revenue increase to provide a \$227,309 operating income for a 9.89 percent rate of return on a \$2,298,376 FVRB. A hearing in this matter commenced on July 26, 2011, continued through July 28, 2011, and was scheduled to reconvene on September 12 and 13, 2011, until vacated to accommodate preparation of a “Settlement Agreement” and supporting testimony by some of the parties (Goodman and intervenors RUCO, Lawrence Wawryzniak and James Schoemperlen) that had come to terms regarding significant disputed issues. The parties to the Settlement Agreement (“Signatories”) had neither invited the Commission Utilities Division Staff (“Staff”) to participate in the settlement discussions nor disclosed to Staff that the discussions were taking place until an agreement in principle had been reached regarding the rate application.

A Procedural Order, dated September 15, 2011, established, pursuant to an agreement by the parties, dates for (1) filing the Settlement Agreement (September 15, 2011), (2) filing testimony supporting the settlement (October 4, 2011), (3) filing testimony opposing the settlement (October 24, 2011) and (4) conducting a hearing (October 31 and November 1, 2011). The purpose of this Supplemental Staff Report is to present Staff’s comments on the Settlement Agreement and the testimonies of the Signatories. Staff’s comments identify reasons that the Commission should not adopt the Settlement Agreement as filed, and identifies an alternative that preserves most of the Signatories’ claimed benefits while avoiding its multiple pitfalls. Staff supports this alternative presented in the attached Phase 1, Phase 2 and Phase 3 Schedules GLF-1 through GLF-20.

Staff provided its Updated Surrebuttal Schedules to the Signatories for consideration in preparation of their testimonies in support of the Settlement Agreement. Staff’s updated Surrebuttal revenue requirement of \$797,063 represents an increase of \$202,604, or 34.08 percent, over test year revenue of \$594,459 for a 9.2 percent rate of return on a Staff-adjusted FVRB of \$2,077,253. Staff’s updated Surrebuttal revenue requirement represents a \$21,780 increase from its initial Surrebuttal testimony. Staff’s updated revenue requirement reflects a correction to remove Advances in Aid of Construction related to mains that were double counted in the calculation of accumulated deferred income taxes; adjustments to Land and Structures and Improvements to recognize the fully-allocated cost of purchases from an affiliate; and the consequential effects on depreciation expense, accumulated depreciation, property and income taxes and rate design.²

¹ The Company did not propose a FVRB that differs from its original cost rate base.

² All of the incremental revenue requirement is attributed to the commodity rates.

SETTLEMENT AGREEMENT

The Settlement Agreement resolves points of contention among the Signatories regarding: overall revenue increase; fair value rate base; excess capacity; phase-in rates; rate design; and stay out provision.³ The settlement is in the form of a “black box,” i.e., no specific revenue, expense, or rate base adjustments are identified. Agreement is limited to only the amounts specifically identified in the Settlement Agreement. The primary impetus for the settlement was Goodman’s decision to reach out to its customers in the Eagle Crest Ranch Community and to intervenors.⁴ A secondary purpose was to avoid the expense and delay associated with continued protracted litigation.⁵

The primary issues specified in the Settlement Agreement are as follows:

1. A \$138,000 revenue increase⁶ with a three-year phase-in: Year 1, 11.6%; Year 2, 5.80%; and Year 3, 5.8%. There will be no compounding and the Company also waives its right to foregone revenues and any interest thereon.⁷
2. Total revenues of \$732,459.⁸
3. FVRB is \$1,755,118.⁹
4. No conclusion as to whether excess capacity exists.¹⁰
5. The Company agrees not to file for another permanent increase in its rates for water service until at least January 1, 2015, using a test year no earlier than the twelve (12) months ended December 31, 2014 (“Stay Out”).¹¹
6. The Commission will authorize Goodman to defer \$269,307 of accumulated depreciation through the end of the test year.¹²
7. The Commission will authorize Goodman to defer the recording of annual depreciation of \$44,136 on utility plant currently in service, which is not included in rate base for purposes of this rate case during the Stay Out period.¹³

Staff’s comments regarding these primary components of the Settlement Agreement are presented below.

³ Settlement Agreement, paragraph 1.15.

⁴ *Id.*, paragraph 1.11.

⁵ *Id.*, paragraph 1.17.

⁶ *Id.*, paragraph 2.1.

⁷ *Id.*, paragraph 2.6.

⁸ *Id.*, paragraph 2.1.

⁹ *Id.*, paragraph 2.2.

¹⁰ *Id.*, paragraph 2.5.

¹¹ *Id.*, paragraph 2.8.

¹² *Id.*, paragraph 2.3.

¹³ *Id.*

ENGINEERING ANALYSIS¹⁴

Plant-in-Service Adjustments

In this rate case proceeding, Staff field inspected and evaluated the Company's water system to determine if any plant facilities had excess capacity or were not used and useful. Based on Staff's evaluation, Staff concluded that:

1. Not Used and Useful – The Company's plant-in-service consisted of certain identified plant facilities that were not used and useful. Therefore, Staff made a plant-in-service adjustment totaling to \$128,600 for plant items considered not used and useful in this proceeding. Staff's final plant-in-service adjustment is shown in its Surrebuttal Testimony.
2. Capacity – The Company's plant-in-service did not have any excess capacity. The Company's water system consisted of two wells (total production of 1,300 gallons per minute) and two storage tanks (totaling to 1,000,000 gallons), with 803,000 gallons of useable capacity. The Company does not request to include in rate base in this rate case the \$72,350 cost for the 190,000 gallon "upsizing" of Water Plant No. 3, reducing the total useable capacity requested in this case to 613,000 gallons. Based on these factors, Staff determined that the operation of the two wells and two storage tanks could adequately serve up to 933 service connections.

During the test year 2009, the Company had 621 service connections and Staff projected that the Company could have approximately 875 service connections within a five-year period. The total storage tank capacity of 1,000,000 gallons, with 613,000 gallons of useable capacity for this rate case, is not unreasonable because only 13,340 gallons (58 connections x 230 GPD per connection), or 7 percent, exceeds the **minimum** one-day storage requirement. This 13,340-gallon extra storage capacity would enable the Company to service unanticipated higher peak demand. Further, this storage is used operationally as discussed below.

From an operational standpoint, Staff did not find excess plant capacity for the following reasons: (1) this system serves different pressure zones; (2) due to different pressure zones, additional plant facilities are needed to deliver adequate water pressure and to meet fire flow requirements; (3) this system provides looped service to some customers; i.e., if water service is disrupted in one direction, then water service could continue from another direction; and (4) the location of the customers. An example of customer location is as follows: In the most-northern portion of the water system, Water Plant No. 3 could serve approximately 50 lots in Phase 5-B of Eagle Crest Ranch. During the test year, approximately six lots

¹⁴ Sponsored by Marlin Scott, Jr.

were being served in this Phase 5-B subdivision. Three of the six lots are located at the end of the line at the most western end of the ridge. In order for these three lots to receive adequate water service (adequate pressure plus fire flow protection), the entire water main from Water Plant No. 3 to the customers and the entire Water Plant No. 3 itself are needed to provide reliable and continuous service.

The 1,300 GPM total well capacity is not excessive because one well is a back-up to the other in case one well is placed out of service. In addition, the total well capacity supplements the fire flow requirement.

In contrast to Staff's conclusion that there is no plant-in-service excess capacity, the Settlement Agreement specifically states, "the Signatory Parties reach no conclusion as to whether or not any "excess capacity" may or may not exist at this time on the Company's system."¹⁵

Depreciation Rates

The Settlement Agreement does not specify any depreciation rates. Staff recommends that the Company continue to use the depreciation rates by individual National Association of Regulatory Utility Commissioners category as presented in Table I-1 of the Engineering Report in Staff's Direct Testimony.

FINANCIAL ANALYSIS¹⁶

Although the Settlement Agreement specifies a FVRB of \$1,755,118, total revenues of \$732,459, and an increase in revenues of \$138,000, it does not specify essential financial elements, including: (1) plant values; (2) accumulated depreciation balance; (3) depreciation rates; (4) operating income; (5) total or individual operating expenses; (6) capital structure; and (7) rate of return or the cost rates for its debt and equity components. The black box format adopted specifically denies any specific revenue, expense, or rate base adjustments. This approach precludes the determination or inference of elements necessary for determining the revenue requirement in a future rate case (accumulated depreciation) and frustrates assessment of the reasonableness of the revenues and rates (rate of return). For example, although the \$1,755,118 FVRB is RUCO's Surrebuttal position,¹⁷ the underlying adjustments and resulting components of rate base cannot be assumed.¹⁸ As a result, implementation of Settlement Agreement paragraph 2.3 that allows Goodman "to defer the recording of annual depreciation of \$44,136 on utility plant currently in service, which is not included in rate base for purposes of

¹⁵ Id., paragraph 2.5.

¹⁶ Sponsored by Gordon L. Fox

¹⁷ Jodi A. Jerich, Settlement Agreement Testimony, p. 4.

¹⁸ Contrary to the black box format adopted by the Settlement Agreement, RUCO claims that the Settlement Agreement adopts its recommended adjustments to the test year level of accumulated depreciation and depreciation expense – specific components of the FVRB. Jodi A. Jerich, Settlement Agreement Testimony, p. 7.

this rate case, during the “Stay Out” period” cannot occur because the portion of plant not included in rate base is not identified or identifiable. In turn, the portion of plant that is in rate base and subject to depreciation is not identified or identifiable. As a result, the amount of accumulated depreciation in a future rate case will be undeterminable. The absence of specified depreciation rates aggravates this defect.

The absence of a specified operating income and resulting rate of return is another significant defect in the Settlement Agreement. Rate of return is the primary metric for determining the reasonableness of the revenues and rates; accordingly, the reasonableness of the rates must be assessed on a less-desirable and informative basis. The lack of a specified capital structure or the cost rates for debt and equity further exacerbate the inability to assess the reasonableness of the revenue and rates.

The omission of firm values for plant items means that in the next rate case the most recent determination of plant values will have been in Decision No. 69404 for a test year ending September 30, 2005, and that plant additions from that date forward will be subject to contention in the future rate case. As a consequence, Staff and potentially other parties will duplicate efforts already performed in the instant case and invite new potential contentions resulting in inefficient use of resources.

The major rate base issue in the instant case is whether plant-in-service includes excess capacity.¹⁹ The Settlement Agreement makes no determination regarding whether excess capacity exists and punts it forward to the next rate case under the general theme that the settlement will appease homeowners in the Eagle Crest Ranch community garnering support by existing homeowners for others to build new homes, thus creating growth to mitigate/eliminate the excess capacity discord between Goodman and the intervenors in the future. While these hopes may be fulfilled, whether any substantive growth will occur is unknown. Another significant plant issue in this case is the valuation of four land parcels for well sites Goodman purchased from an affiliate. The Settlement agreement does not resolve the valuation of these parcels. It is inefficient to postpone to a future rate case the resolution of these land valuations upon which significant resources have already been expended in the current case.

Paragraph 2.3 of the Settlement Agreement states:

For ratemaking purposes and for the purposes of this Agreement, the Signatory Parties agree that as a condition of approval of this Agreement, the Commission will authorize Goodman to defer \$269,307 of accumulated depreciation through the end of the test year and to defer the recording of annual depreciation of \$44,136 on utility plant currently in service, which is not included in rate base for purposes of this rate case, during the “Stay Out” period

¹⁹ The value of the excess capacity adjustment proposed by RUCO is \$1,360,580, Timothy J. Coley, Surrebuttal Testimony, p. 2.

The meaning of paragraph 2.3 is further explained in the Settlement Agreement testimony of Thomas J. Bourassa at page 4, as follows:

This provision recognizes that the agreed upon revenue requirement and lower rate base does not recognize certain plant and equipment constructed since the last rate case. This provision is a key provision as the Company's rates have not and will not include depreciation at least until the next rate case some time after January 1, 2015.

In other words, the Settlement Agreement would (1) reach back to the effective date (May 1, 2007) of rates established in Decision No. 69404 for the prior rate case and restate depreciation that occurred on certain unspecified plant over the period beginning May 1, 2007, and ending December 31, 2009 (32 months) as a \$269,307 deferral and (2) defer \$44,136 of the amount of depreciation on unspecified plant that has been and will be recorded over the period beginning January 1, 2010, through December 31, 2014 (5 years), for a total amount of deferrals to be considered for recovery in the next rate case of \$489,987 $[(5 \times \$44,136) + \$269,307]$.

The provisions of paragraph 2.3 present several concerns. First, the anticipated \$489,987 deferral represents 66.9 percent $(\$489,987 \div \$732,459)$ of the proposed annual revenue requirement. Whatever method is authorized in the next rate case for recovering this deferral, it would place significant additional upward pressure on rates in addition to any other rate increase deemed appropriate at that time, and it has the potential to renew any contentiousness between Goodman and its customers that is ameliorated via the settlement in this rate case.

Second, deferring depreciation expense creates an intergenerational transfer of costs from current ratepayers to future ratepayers.

Finally, and most egregiously, paragraph 2.3 calls for restating depreciation expense that was incurred in the past. The regulatory framework does not provide for any such restatement. The regulatory framework for deferring expenses is a prospective view, i.e., expenses incurred subsequent to regulatory approval can be deferred for consideration of recovery as authorized at a later date. Accordingly, although Staff in this case opposes authorization to defer depreciation expense going forward, at least such deferral is consistent with the regulatory framework. However, paragraph 2.3 contemplates not only deferral of depreciation going forward, but also the restatement of depreciation expense incurred in the past. The latter is retroactive ratemaking. Under the regulatory framework, ratepayers have already paid any expenses that have occurred prior to the time the regulatory authority authorized the deferral. Thus, the provisions of paragraph 2.3 would have ratepayers pay a second time, assuming recovery of the deferred amount is authorized in the next rate case, for depreciation expense already paid by ratepayers on certain specified plant beginning on May 1, 2007, through the effective date of rates established in this case.

In summary, the Settlement Agreement contains multiple defects. Accordingly, the Settlement Agreement should be rejected.

Despite these Settlement Agreement defects, Staff recognizes and respects the efforts and stated objectives of the Signatories. In this case, with greatly divergent positions among the participants, it is in the public interest to find reasonable common ground through compromise. Accordingly, it is desirable to adopt an alternative resolution that refines the Settlement Agreement by retaining many of its salient features and discarding its major faults. Staff concludes that such an alternate resolution can be achieved by simply retaining the revenue requirement and revenue increase (with the three-year phase-in), the rate design²⁰ and the Stay Out features as contemplated by paragraphs 2.1, 2.2, 2.6, 2.7 and 2.8 of the Settlement Agreement; rejecting paragraphs 2.3 and 2.4 pertaining to the deferral of depreciation and accumulated depreciation; rejecting paragraph 2.5 pertaining to recognition of excess capacity; and adopting Staff's recommended rate base, operating expenses and depreciation rates.

Recognizing Staff's rate base resolves the excess capacity and land valuation issues and provides a basis for determining critical components of rate base in the next rate case. Recognizing Staff's rate base in concert with its operating expenses provides a basis for determining an operating income and the reasonableness of the rates adopted in this rate case. The trade-off of this alternative versus the Settlement Agreement is that the Company will forgo the opportunity to recover from ratepayers in its next rate case depreciation deferrals in exchange for certain recognition of the plant that is challenged as excess capacity in this rate case.

Under Staff's alternative resolution, the step-one, step-two and step-three operating incomes are \$116,041, \$135,425, and \$154,809, respectively, for 5.59, 6.52 and 7.45 percent rates of return on a \$2,077,253 fair value rate base. Since these results provide sufficient cash flow to meet all of Goodman's obligations, Staff finds these alternative revenues and rates reasonable as long as Goodman also finds them acceptable.

STAFF RECOMMENDATIONS

Staff recommends:

1. That the Commission reject the Settlement Agreement.
2. Adoption of the three-year phase-in revenue requirements, rates of return and rate designs as discussed herein and presented in the attached Phase 1, Phase 2 and Phase 3 Schedules GLF-1 through GLF-20, along with adoption of Staff's rate base and operating expenses as presented in Staff's Updated (9/12/11) Surrebuttal Schedules GLF-1 through GLF-20 and Staff's recommended depreciation rates.

²⁰ Staff's rate design varies somewhat from that of the Settlement Agreement.

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

TESTIMONY - GORDON L. FOX (9/12/11)

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REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY FAIR VALUE	(C) STAFF ORIGINAL COST	(D) STAFF FAIR VALUE
1	Adjusted Rate Base	\$ 2,402,222	\$ 2,402,222	\$ 2,077,253	\$ 2,077,253
2	Adjusted Operating Income (Loss)	\$ 73,882	\$ 73,882	\$ 71,259	\$ 71,259
3	Current Rate of Return (L2 / L1)	3.08%	3.08%	3.43%	3.43%
4	Required Rate of Return	10.54%	10.54%	9.20%	9.20%
5	Required Operating Income (L4 * L1)	\$ 253,194	\$ 253,194	\$ 191,107	\$ 191,107
6	Operating Income Deficiency (L5 - L2)	\$ 179,312	\$ 179,312	\$ 119,848	\$ 119,848
7	Gross Revenue Conversion Factor	1.6254	1.6254	1.6905	1.6905
8	Required Revenue Increase (L7 * L6)	\$ 291,454	\$ 291,454	\$ 202,604	\$ 202,604
9	Adjusted Test Year Revenue	\$ 572,751	\$ 572,751	\$ 594,459	\$ 594,459
10	Proposed Annual Revenue (L8 + L9)	\$ 864,205	\$ 864,205	\$ 797,063	\$ 797,063
11	Required Increase in Revenue (%)	50.89%	50.89%	34.08%	34.08%
12	Rate of Return on Common Equity (%)	11.00%	11.00%	9.10%	9.10%

References:

Column (A): Company Schedule B-1
Column (B): Company Schedule B-1
Column (C): Company Schedules A-1, A-2, & D-1
Column (D): Staff Schedule GLF-2 , GLF-3 & GLF-11

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.0000%			
3	Revenues (L1 - L2)	100.0000%			
4	Combined Federal and State Tax Rate (Line 17) + Property Tax Factor (Line 23)	40.8462%			
5	Subtotal (L3 - L4)	59.1538%			
6	Revenue Conversion Factor (L1 / L5)	1.6905			
<u>Calculation of Uncollectible Factor:</u>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	40.2523%			
9	One Minus Combined Income Tax Rate (L7 - L8)	59.7477%			
10	Uncollectible Rate	0.0000%			
11	Uncollectible Factor (L9 * L10)	0			
<u>Calculation of Effective Tax Rate:</u>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	6.9680%			
14	Federal Taxable Income (L12 - L13)	93.0320%			
15	Applicable Federal Income Tax Rate (Line 53)	35.7772%			
16	Effective Federal Income Tax Rate (L14 x L15)	0.332842837			
17	Combined Federal and State Income Tax Rate (L13 + L16)	40.2523%			
<u>Calculation of Effective Property Tax Factor</u>					
18	Unity	100.0000%			
19	Combined Federal and State Tax Rate (Line 17)	40.2523%			
20	One Minus Combined Income Tax Rate (L18 - L19)	59.7477%			
21	Property Tax Factor (GLF-17, L26)	0.9941%			
22	Effective Property Tax Factor (L 21 * L 22)	0.5940%			
23	Combined Federal and State Tax and Property Tax Rate (L17+L22)		40.8462%		
24	Required Operating Income (Schedule GLF-1, Line 5)	\$ 191,107			
25	Adjusted Test Year Operating Income (Loss) (Schedule GLF-11, Line 33)	\$ 71,259			
26	Required Increase in Operating Income (L24 - L25)		\$ 119,848		
27	Income Taxes on Recommended Revenue (Col. (D), L52)	\$ 90,802			
28	Income Taxes on Test Year Revenue (Col. (B), L52)	\$ 10,060			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		\$ 80,742		
30	Recommended Revenue Requirement (Schedule GLF-1, Line 10)	\$ 797,063			
31	Uncollectible Rate (Line 10)	0.0000%			
32	Uncollectible Expense on Recommended Revenue (L24 * L25)	\$ -			
33	Adjusted Test Year Uncollectible Expense	\$ -			
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32 - L33)		\$ -		
35	Property Tax with Recommended Revenue (GLF-17, L21)	\$ 21,063			
36	Property Tax on Test Year Revenue (GLF-17, L22)	\$ 19,049			
37	Increase in Property Tax Due to Increase in Revenue (GLF-17, L23)		\$ 2,014		
38	Total Required Increase in Revenue (L26 + L29 + L34+L37)		\$ 202,604		
<u>Calculation of Income Tax:</u>					
39	Revenue (Schedule GLF-11, Col.[C], Line 5 & Sch. GLF-1, Col. [D], Line 10)	\$ 594,459			
40	Operating Expenses Excluding Income Taxes	\$ 513,139			
41	Synchronized Interest (L56)	\$ 33,236			
42	Arizona Taxable Income (L39 - L40- L41)	\$ 48,083			
43	Arizona State Income Tax Rate	6.9680%			
44	Arizona Income Tax (L42 x L43)	\$ 3,350			\$ 17,328
45	Federal Taxable Income (L42 - L44)	\$ 44,733		\$ 231,346	
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ 6,710		\$ 7,500	
47	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	\$ -		\$ 6,250	
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -		\$ 8,500	
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -		\$ 51,225	
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -		\$ -	
51	Total Federal Income Tax	\$ 6,710			\$ 73,475
52	Combined Federal and State Income Tax (L44 + L51)	\$ 10,060			\$ 90,802
53	Applicable Federal Income Tax Rate [Col. (D), L51 - Col. (B), L51] / [Col. (C), L44 - Col. (A), L44]				35.78%
<u>Calculation of Interest Synchronization:</u>					
54	Rate Base (Schedule GLF-3, Col. [C], Line (14))	\$ 2,077,253			
55	Weighted Average Cost of Debt (Surrebuttal Schedule JCM-1)	1.60%			
56	Synchronized Interest (L54 X L55)	\$ 33,236			

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-3
Date: 9/12/11

RATE BASE - ORIGINAL COST

LINE NO.		(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	REF	(C) STAFF AS ADJUSTED
1	Plant in Service	\$ 5,453,761	\$ (487,242)		\$ 4,966,519
2	Less: Accumulated Depreciation	731,205	16,013		747,218
3	Net Plant in Service	<u>\$ 4,722,556</u>	<u>\$ (503,255)</u>		<u>\$ 4,219,301</u>
	<u>LESS:</u>				
4	Contributions in Aid of Construction (CIAC)	\$ -	\$ -		\$ -
5	Less: Accumulated Amortization	-	-		-
6	Net CIAC	<u>\$ -</u>	<u>\$ -</u>		<u>\$ -</u>
7	Advances in Aid of Construction (AIAC)	2,101,905	(128,600)		1,973,305
8	Service Line & Meter Installation Charges	83,087	-		83,087
9	Deferred Income Tax Credits	135,342	(49,686)		85,656
	<u>ADD:</u>				
10	Unamortized Finance Charges	-	-		-
11	Deferred Tax Assets	-	-		-
12	Working Capital	-	-		-
13	Intentionally Left Blank	-	-		-
14	Original Cost Rate Base	<u>\$ 2,402,222</u>	<u>\$ (324,969)</u>		<u>\$ 2,077,253</u>

References:

Column (A), Company Schedule B-1
Column [B]: Column [C] - Column [A]
Column [C], GLF-4

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	ACCT. NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) LAND ADJ #1	(C) WATER TREATMENT ADJ #2	(D) DISTRIBUTION RESERVOIR ADJ #3	(E) DISTRIBUTION RESERVOIR ADJ #4	(F) TRANSMISSION MAINS ADJ #5	(G) ACCUMULATED DEPRECIATION ADJ #6	(C) AIAC ADJ #7	(H) ADIT ADJ #8	(J) STAFF ADJUSTED
PLANT IN SERVICE:												
1	301	Organization Cost	\$ 127,103	-	-	-	-	-	-	-	-	\$ 127,103
2	302	Franchise Cost	-	-	-	-	-	-	-	-	-	-
3	303	Land and Land Rights	494,169	(472,521)	-	-	-	-	-	-	-	21,638
4	304	Structures and Improvements	182,570	186,229	-	-	-	-	-	-	-	368,799
5	305	Collecting and Impounding Res.	-	-	-	-	-	-	-	-	-	-
6	306	Lake River and other Intakes	-	-	-	-	-	-	-	-	-	-
7	307	Wells and Springs	386,591	-	-	-	-	-	-	-	-	386,591
8	308	Infiltration Galleries and Tunnels	-	-	-	-	-	-	-	-	-	-
9	309	Supply Mains	-	-	-	-	-	-	-	-	-	-
10	310	Power Generation Equipment	-	-	-	-	-	-	-	-	-	968,652
11	311	Electrical Pumping Equipment	968,652	-	(15,947)	-	-	-	-	-	-	-
12	320	Water Treatment Equipment	15,947	-	-	-	-	-	-	-	-	-
13	320.1	Water Treatment Plant	-	-	-	-	-	-	-	-	-	-
14	320.2	Chemical Solution Feeders	-	-	-	-	-	-	-	-	-	-
15	330	Distribution Reservoirs & Standpipe	836,890	-	-	(836,890)	(72,350)	-	-	-	-	312,477
16	330.1	Storage Tanks	-	-	-	384,827	-	-	-	-	-	452,063
17	330.2	Pressure Tanks	-	-	-	452,063	-	(128,600)	-	-	-	1,482,720
18	331	Transmission and Distribution Mains	1,611,320	-	-	-	-	-	-	-	-	386,947
19	333	Services	386,947	-	-	-	-	-	-	-	-	161,737
20	334	Meters	94,263	-	-	-	-	-	-	-	-	-
21	335	Hydrants	161,737	-	-	-	-	-	-	-	-	187,582
22	336	Backflow Prevention Devices	-	-	-	-	-	-	-	-	-	-
23	339	Other Plant & Miscellaneous Equipment	187,582	-	-	-	-	-	-	-	-	-
24	340	Office Furniture & Fixtures	-	-	-	-	-	-	-	-	-	-
25	340.1	Computers & Software	-	-	-	-	-	-	-	-	-	-
26	341	Transportation Equipment	-	-	-	-	-	-	-	-	-	-
27	342	Stores Equipment	-	-	-	-	-	-	-	-	-	-
28	343	Tools and Work Equipment	-	-	-	-	-	-	-	-	-	-
29	344	Laboratory Equipment	-	-	-	-	-	-	-	-	-	-
30	345	Power Operated Equipment	-	-	-	-	-	-	-	-	-	-
31	346	Communications Equipment	-	-	-	-	-	-	-	-	-	-
32	347	Miscellaneous Equipment	-	-	-	-	-	-	-	-	-	-
33	348	Other Tangible Plant	-	-	-	-	-	-	-	-	-	-
34		Rounding Amount	\$ 5,453,761	\$ (286,292)	-	-	\$ (72,350)	\$ (128,600)	-	-	-	\$ 4,966,519
35		Subtotal Plant in Service										
36	Add:											
37	Other 1	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
38	Other 2	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
39	Less:											
40	Other 3	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
41	Other 4	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
42		Total Plant in Service:	\$ 5,453,761	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ 16,013	\$ -	\$ -	\$ 4,966,519
43	Less:	Accumulated Depreciation	731,205	-	-	-	-	-	-	-	-	\$ 747,218
44		Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
45		Net Plant in Service (L59 - L60)	\$ 4,722,556	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ (16,013)	\$ -	\$ -	\$ 4,219,301
46												
47	LESS:											
48	Contributions in Aid of Construction (CIAC)											
49	Less: Accumulated Amortization											
50	Net CIAC (L49 - L50)											
51	Advances in Aid of Construction (AIAC)											
52	Service Line & Meter Installation Charges		2,101,905	-	-	-	-	-	-	(128,600)	-	1,973,305
53	Deferred Income Tax Credit		83,067	-	-	-	-	-	-	-	(49,686)	83,067
54			135,342	-	-	-	-	-	-	-	-	85,656
55	ADD:											
56	Unamortized Finance Charges		-	-	-	-	-	-	-	-	-	-
57	Deferred Tax Assets		-	-	-	-	-	-	-	-	-	-
58	Working Capital		-	-	-	-	-	-	-	-	-	-
59	Regulatory Asset (Liability)		-	-	-	-	-	-	-	-	-	-
60	Original Cost Rate Base		\$ 2,402,222	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ (16,013)	\$ 128,600	\$ 49,686	\$ 2,077,253

References:
Column [A] Schedule B-2, E-1

ORIGINAL COST RATE BASE ADJUSTMENT # 1 - LAND PURCHASE

LINE NO.	Description	Account Number	COMPANY PROPOSED	STAFF ADJUSTMENTS	STAFF RECOMMENDED		
1	Land and Land Rights	303	\$ 494,159	\$ (472,521)	\$ 21,638		
2	Structures & Improvements	304	\$ 182,570	\$ 186,229	\$ 368,799		
			Plant 1 0.72 Acres	Plant 2 0.25 Acres	Plant 4 0.39 Acres	Plant 3 0.63 Acres	Total 1.99 Acres
Land:							
3	Purchase Price (467.155 Acres)	\$ 4,103,318	\$ 6,324	\$ 2,196	\$ 3,426	\$ 5,534	\$ 17,479
4	Closing Costs						\$ 2,159
5	Appraisal Fee						\$ 2,000
6	Total Land						<u>\$ 21,638</u>
Structures and Improvements:							
7	GRA Improvements 4/15/85 to 6/12/01	\$ 795,363	\$ 1,226	\$ 426	\$ 664	\$ 1,073	\$ 3,388
8	Phase I Development Costs (68.93 Acres)	\$ 7,283,576	76,080	26,417	-	-	\$ 102,496
9	Phase III Development Costs (43.66 Acres)	\$ 2,284,877	-	-	20,410	-	\$ 20,410
10	Phase IV Development Costs (95.705 Acres)	\$ 9,104,785	-	-	-	59,934	\$ 59,934
11	Total Add'l Structures and Improvements		<u>\$ 77,306</u>	<u>\$ 26,842</u>	<u>\$ 21,074</u>	<u>\$ 61,007</u>	<u>\$ 186,229</u>
Accumulated Depreciation - Structures and Improvements - Book:							
In Service Date:			5/1/02	8/1/05	1/1/08	10/1/08	
12	Depreciation Basis (Line 11)		\$ 77,306	\$ 26,842	\$ 21,074	\$ 61,007	\$ 186,229
13	Depreciation - 2002 (2.5%)		966				966
14	Depreciation - 2003 (2.5%)		1,933				1,933
15	Depreciation - 2004 (2.5%)		1,933				1,933
16	Depreciation - 2005 (2.5%)		1,933	336			2,268
17	Depreciation - 2006 (2.5%)		1,933	671			2,604
18	Depreciation - 2007 (2.5%*4/12) +(3.33%*8/12) ¹		2,360	820			3,180
19	Depreciation - 2008 (3.33%)		2,574	894	351	1,016	4,835
20	Depreciation - 2009 (3.33%) - Test Year		2,574	894	702	2,035	6,204
21	Accumulated Depreciation (Sum Lines 13 thru 20) ²		<u>\$ 16,206</u>	<u>\$ 3,614</u>	<u>\$ 1,053</u>	<u>\$ 3,050</u>	<u>\$ 23,923</u>

¹ Depreciation rate changed from 2.5% to 3.33% May 1, 2007.

² \$23,923 adjustment to A/D is reflected in GLF-10, Line 2.

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ORIGINAL COST RATE BASE ADJUSTMENT # 2 - RECLASSIFY WATER TREATMENT EQUIPMENT

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	320	Water Treatment Equipment	\$ 15,947	\$ (15,947)	\$ -
2	320.1	Water Treatment Plant		-	-
3	320.2	Chemical Solution Feeders		\$ 15,947	\$ 15,947
4		Total	<u>\$ 15,947</u>	<u>\$ -</u>	<u>\$ 15,947</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony , SDR GTM-1.5
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-7
Date: 9/12/11

ORIGINAL COST RATE BASE ADJUSTMENT # 3 - RECLASSIFY DISTRIBUTION RESERVOIRS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	330	Distribution Reservoirs & Standpipe	\$ 836,890	\$ (836,890)	\$ -
2	330.1	Storage Tanks		\$ 384,827	\$ 384,827
3	330.2	Pressure Tanks		\$ 452,063	\$ 452,063
4		Total	<u>\$ 836,890</u>	<u>\$ -</u>	<u>\$ 836,890</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony, SDR GTM-1.4

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-8
Date: 9/12/11

ORIGINAL COST RATE BASE ADJUSTMENT # 4 - ELIMINATE EXCESS CAPACITY - STORAGE TANK

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	331	Storage Tanks ¹	\$ 384,827	\$ (72,350)	\$ 312,477

¹ The Company proposed amount is the portion claimed by the Company and reclassified by Staff to Acct. 330.1 as shown in GTM-7.

References:

Col [A]: Company Schedule B-1
Col [B]: GLF and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-9
Date: 9/12/11

ORIGINAL COST RATE BASE ADJUSTMENT # 5 - ELIMINATE EXCESS CAPACITY - DISTRIBUTION MAINS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	333	Transmission and Distribution Mains	<u>1,611,320</u>	<u>\$ (128,600)</u>	<u>\$ 1,482,720</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

ORIGINAL COST RATE BASE ADJUSTMENT # 6 - ADJUST ACCUMULATED DEPRECIATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Depreciation	\$ 731,205	\$ 16,013	\$ 747,218
			Accumulated Depreciation per application	Accumulated Depreciation per Staff	Difference
2		Structures and Improvements	\$ 10,285	\$ 34,208	\$ 23,923
3		Collecting and Impounding Res.	-	-	-
4		Lake River and other Intakes	-	-	-
5		Wells and Springs	67,423	67,423	0
6		Infiltration Galleries and Tunnels	-	-	-
7		Supply Mains	-	-	-
8		Power Generation Equipment	-	-	-
9		Electrical Pumping Equipment	341,101	341,101	0
10		Water Treatment Equipment	2,167	0	(2,167)
11		Water Treatment Plant	-	-	-
12		Chemical Solution Feeders	-	2,167	2,167
13		Distribution Reservoirs & Standpipe	64,318	-	(64,318)
14		Storage Tanks	-	27,712	27,712
15		Pressure Tanks	-	32,553	32,553
16		Transmission and Distribution Mains	139,059	135,201	(3,858)
17		Services	40,947	40,947	-
18		Meters	17,066	17,066	-
19		Hydrants	12,984	12,984	-
20		Backflow Prevention Devices	-	-	-
21		Other Plant & Miscellaneous Equipment	35,847	35,847	-
22		Office Furniture & Fixtures	-	-	-
23		Computers & Software	-	-	-
24		Transportation Equipment	-	-	-
25		Stores Equipment	-	-	-
26		Tools and Work Equipment	-	-	-
27		Laboratory Equipment	-	-	-
28		Power Operated Equipment	-	-	-
29		Communications Equipment	-	-	-
30		Miscellaneous Equipment	-	-	-
31		Other Tangible Plant	-	-	-
			\$ 731,197	\$ 747,210	\$ 16,013

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony, RUCO DR 2.12
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-10.1
Date: 9/12/11

ORIGINAL COST RATE BASE ADJUSTMENT # 7 - REDUCE AIAC

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	108	AIAC	<u>2,101,905</u>	<u>\$ (128,600)</u>	<u>\$ 1,973,305</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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ORIGINAL COST RATE BASE ADJUSTMENT # 8 - ACCUMULATED DEFERRED INCOME TAX

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Deferred Income Tax	<u>135,342</u>	<u>\$ (49,686)</u>	<u>\$ 85,656</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

ADIT Calculation

	Adj Book Value	Tax Value	Realization Probability	Expected Realized (Taxable TD) Deductible TD	Tax Rate	Future Tax Asset Current	Non-current	Future Tax Liability Current	Non-current
PIS	4,966,519								
A/D	(747,218)								
CIAC	(1,381,314)								
Total/ Fixed Assets	2,837,988	2,019,279	100%	(818,709)	37.8%				(309,316)
AIAC		1,973,305	30%	591,992	37.8%		223,660		
Totals						-	223,660	-	(309,316)

ADIT Net Asset (Liability) - Staff	(85,656)
ADIT Net Asset (Liability) Company as Filed	(135,342)
Staff Adjustment	49,686

Computation of Net Tax Value at Dec. 31, 2009:

Unadjusted Cost per 2009 Tax Deprec Report	4,938,108
Reconciling Items not on tax report	
Net Structures and Improvement to Land not on tax, used in rates	162,306
Adjusted land costs not on tax, on books (Staff adjusted Land Value)	21,638
Net Unadjusted Cost Tax Basis	5,122,053

Basis Reductions/Additions:

Basis reduction 2009 and prior years	(14,706)
Advance or Contr plant with no deprec basis listed on 2009 Tax Deprec Report	(2,707,816)
Accumulated Depreciation 2008 and prior (2009 Tax Deprec Report)	(339,352)
Upsizing Adjustment - Tank	(72,350)
Tax Depreciation related to Tank Upsizing	4,341
Excess Capacity - Mains	128,600
Tax Depreciation related to Excess Capacity - Mains (2008) (AIAC no depr)	-
2009 Current Year Tax Depreciation	(101,491)
Net Basis Reduction 2007 and Prior years	(3,102,774)
Net tax value of PIS at Dec. 31, 2008	2,019,279

CIAC (including impact of change to probability of realization)

Gross CIAC (Schedule B-2)	-
Less: Pre-1996 CIAC	-
A.A.	-
A.A. on Pre-1996	-
A.A. on Post 1996 CIAC	-
Net CIAC before unrealized AIAC	-

Unrealized AIAC Component:

Adjusted Net AIAC	1,973,305
AIAC funding Mains	-
Sub-total	1,973,305
Unrealized AIAC Component % (1-Realized AIAC Component)	70%
	1,381,314
Total Realizable CIAC	1,381,314

AIAC (including impact of change to probability of realization)

AIAC (Schedule B-2)	1,973,305
Less: Pre-1996 AIAC included for book and tax purposes	-
Net AIAC before unrealized portion	1,973,305
Less: Unrealized AIAC from above	(1,381,314)
Net Realizable AIAC	591,992

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OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

LINE NO.	DESCRIPTION	[A] COMPANY ADJUSTED TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
1	<u>OPERATING REVENUES:</u>					
2	Metered Water Revenues	\$ 559,013	\$ 21,708	\$ 580,721	\$ 202,604	\$ 783,325
3	Unmetered Water Revenues	13,738	-	13,738	-	13,738
4	Other Water Revenues	572,751	21,708	594,459	202,604	797,063
5	Total Operating Revenues	\$	\$	\$	\$	\$
6						
7	<u>OPERATING EXPENSES:</u>					
8	Salaries and Wages	40,000	-	40,000	-	40,000
9	Employee Pensions & Benefits	-	-	-	-	-
10	Purchased Water	27,066	577	27,643	-	27,643
11	Purchased Power	-	-	-	-	-
12	Chemicals	7,746	-	7,746	-	7,746
13	Repairs and Maintenance	14,855	-	14,855	-	14,855
14	Office Supplies and Expense	102,925	-	102,925	-	102,925
15	Outside Services	1,215	1,568	2,783	-	2,783
16	Water Testing	-	-	-	-	-
17	Rents	-	-	-	-	9,669
18	Transportation Expenses	9,669	-	9,669	-	-
19	Insurance - General Liability	-	-	-	-	-
20	Insurance - Health and Life	-	-	-	-	-
21	Advertising	20,000	20,000	40,000	-	40,000
22	Regulatory Comm Expense - Rate Case	378	-	378	-	378
23	Regulatory Comm Expense - Other	-	-	-	-	-
24	Bad Debt Expense	-	-	-	-	-
25	Miscellaneous Expense	227,855	17,249	245,104	-	245,104
26	Depreciation and Amortization	-	-	-	-	-
27	Interest on Security Deposits	2,988	-	2,988	-	2,988
28	Taxes other than Income	21,299	(2,250)	19,049	2,014	21,063
29	Property Taxes	22,873	(12,813)	10,060	80,742	90,802
30	Income Tax	498,869	24,331	523,200	82,756	605,956
31	Total Operating Expenses	\$ 73,882	\$ (2,623)	\$ 71,259	\$ 119,848	\$ 191,107
32	Operating Income					
33						

References:
Column [A]: Company Schedule C-1
Column [B]: Schedule GLF-12
Column [C]: Column [A] + Column [B]
Column [D]: Schedules GLF-1 and GLF-2
Column [E]: Column [C] + Column [D]

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] GLF-13 Revenue Annualization ADJ #1	[C] GLF-14 Rate Case Exp ADJ #2	[D] GLF-15 Water Testing ADJ #3	[E] GLF-16 Depreciation Exp ADJ #4	[F] GLF-17 Property Taxes ADJ #5	[G] GLF-18 Income Taxes ADJ #6	[H] GLF-18.1 An Pur Pwr ADJ #7	[I] STAFF ADJUSTED
1	<u>Operating Revenues:</u>									
2	Metered Water Revenues	\$ 559,013	\$ 21,708		\$ -	\$ -	\$ -	\$ -	\$ -	\$ 580,721
3	Unmetered Water Revenues	-	-		-	-	-	-	-	-
4	Other Water Revenues	13,738	-		-	-	-	-	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 594,459
6										
7	<u>Operating Expenses:</u>									
8	Salaries and Wages	\$ 40,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	40,000
9	Employee Pensions & Benefits	-	-	-	-	-	-	-	-	-
10	Purchased Water	-	-	-	-	-	-	-	-	-
11	Purchased Power	27,066	-	-	-	-	-	-	-	27,066
12	Chemicals	-	-	-	-	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	-	-	-	-	-	-	7,746
14	Office Supplies and Expense	14,855	-	-	-	-	-	-	-	14,855
15	Outside Services	102,925	-	-	-	-	-	-	-	102,925
16	Water Testing	1,215	-	-	1,568	-	-	-	-	2,783
17	Rents	-	-	-	-	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-	-	-	-	-
19	Insurance - General Liability	9,669	-	-	-	-	-	-	-	9,669
20	Insurance - Health and Life	-	-	-	-	-	-	-	-	-
21	Advertising	-	-	-	-	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	-	20,000	-	-	-	-	-	40,000
23	Regulatory Comm Expense - Other	378	-	-	-	-	-	-	-	378
24	Bad Debt Expense	-	-	-	-	-	-	-	-	-
25	Miscellaneous Expense	-	-	-	-	-	-	-	-	-
26	Depreciation and Amortization	227,855	-	-	-	17,249	-	-	-	245,104
27	Interest on Security Deposits	-	-	-	-	-	-	-	-	-
28	Taxes other than Income	2,988	-	-	-	-	-	-	-	2,988
29	Property Taxes	21,299	-	-	-	-	-	-	-	19,049
30	Income Tax	23,873	-	-	-	-	(2,250)	(12,813)	-	10,060
31	Total Operating Expenses	\$ 498,869	\$ -	\$ 20,000	\$ 1,568	\$ 17,249	\$ (2,250)	\$ (12,813)	\$ 577	\$ 523,200
	Operating Income	\$ 73,882	\$ 21,708	\$ (20,000)	\$ (1,568)	\$ (17,249)	\$ 2,250	\$ 12,813	\$ (577)	\$ 71,258

References:
Column [A]: Company Schedule C-1
Column [B] - [G]: Schedule GTM-13 through GTM-17
Column [C]: Add Column [A] - Column [F]

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Schedule GLF-13
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OPERATING INCOME ADJUSTMENT # 1 - REVENUE ANNUALIZATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Metered Water Revenues	<u>\$ 559,013</u>	<u>\$ 21,708</u>	<u>\$ 580,721</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-14
Date: 9/12/11

OPERATING INCOME ADJUSTMENT # 2 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY	[B] STAFF	[C] STAFF
		PROPOSED	ADJUSTMENTS	RECOMMENDED
1	Regulatory Commission Expense - Rate Case	\$ 20,000	\$ 20,000	\$ 40,000

References:

Column [A]: Company Schedule C-1

Column [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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OPERATING INCOME ADJUSTMENT # 3 - WATER TESTING EXPENSE

<u>LINE NO.</u>	<u>Account Number</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1		Water Testing	<u>\$ 1,215</u>	<u>\$ 1,568</u>	<u>\$ 2,783</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

OPERATING INCOME ADJUSTMENT # 4 - DEPRECIATION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Depreciation and Amortization	\$ 227,855	\$ 17,249	\$ 245,104

Line No.	ACCT NO.	DESCRIPTION	[A] Company Proposed PLANT IN SERVICE BALANCE	[B] STAFF DEPR. PLANT BALANCE	[C] STAFF RECOMMENDED RATE	[D] STAFF RECOMMENDED EXPENSE
Plant In Service						
2	301	Organization Cost	\$ 127,103	127,103	0.00%	\$ -
3	302	Franchise Cost	-	-	0.00%	-
4	303	Land and Land Rights	494,159	21,638	0.00%	-
5	304	Structures and Improvements	182,570	368,799	3.33%	12,281
6	305	Collecting and Impounding Res.	-	-	2.50%	-
7	306	Lake River and other Intakes	-	-	2.50%	-
8	307	Wells and Springs	386,591	386,591	3.33%	12,873
9	308	Infiltration Galleries and Tunnels	-	-	6.67%	-
10	309	Supply Mains	-	-	2.00%	-
11	310	Power Generation Equipment	-	-	5.00%	-
12	311	Electrical Pumping Equipment	968,652	968,652	12.50%	121,082
13	320.0	Water Treatment Equipment	15,947	-		-
14	320.1	Water Treatment Plant	-	-	3.33%	-
15	320.2	Chemical Solution Feeders	-	15,947	20.00%	3,189
16	330	Distribution Reservoirs & Standpipe	836,890	-		-
17	330	Storage Tanks	-	312,477	2.22%	6,937
18	330	Pressure Tanks	-	452,063	5.00%	22,603
19	331	Transmission and Distribution Mains	1,611,320	1,482,720	2.00%	29,654
20	333	Services	386,947	386,947	3.33%	12,885
21	334	Meters	94,263	94,263	8.33%	7,852
22	335	Hydrants	161,737	161,737	2.00%	3,235
23	336	Backflow Prevention Devices	-	-	6.67%	-
24	339	Other Plant & Miscellaneous Equipment	187,582	187,582	6.67%	12,512
25	340	Office Furniture & Fixtures	-	-	6.67%	-
26	340	Computers & Software	-	-	20.00%	-
27	341	Transportation Equipment	-	-	20.00%	-
28	342	Stores Equipment	-	-	4.00%	-
29	343	Tools and Work Equipment	-	-	5.00%	-
30	344	Laboratory Equipment	-	-	10.00%	-
31	345	Power Operated Equipment	-	-	5.00%	-
32	346	Communications Equipment	-	-	10.00%	-
33	347	Miscellaneous Equipment	-	-	10.00%	-
34	348	Other Tangible Plant	-	-	3.33%	-
35	-	Rounding Amount	-	-	67.00%	-
36		Subtotal General	\$ 5,453,761	\$ 4,966,519		\$ 245,104
37		Less: Non- depreciable Account(s)	621,262	148,741		
38		Depreciable Plant (L29-L30)	\$ 4,832,499	\$ 4,817,778		
39		Contributions-in-Aid-of-Construction (CIAC)			\$ -	
40		Weighted Average Depreciation/Amortization Rate			5.0875%	
41		Less: Amortization of CIAC (L32 x L33)				\$ -
42		Depreciation Expense - STAFF [Col. (C), L36 - L41]				\$ 245,104

OPERATING INCOME ADJUSTMENT # 5 - PROPERTY TAXES

		[A]	[B]
LINE NO.	Property Tax Calculation	STAFF AS ADJUSTED	STAFF RECOMMENDED
1	Staff Adjusted Test Year Revenues - 2009	\$ 594,459	\$ 594,459
2	Weight Factor	2	2
3	Subtotal (Line 1 * Line 2)	\$ 1,188,918	\$ 1,188,918
4a	Staff Adjusted Test Year Revenues - 2006	594,459	
4b	Staff Recommended Revenue, Per Schedule GLF-1		797,063
5	Subtotal (Line 4 + Line 5)	\$ 1,783,377	\$ 1,985,981
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	\$ 594,459	\$ 661,994
8	Department of Revenue Multiplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	\$ 1,188,918	\$ 1,323,987
10	Plus: 10% of CWIP -		-
11	Less: Net Book Value of Licensed Vehicles		-
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$ 1,188,918	\$ 1,323,987
13	Assessment Ratio	20.0%	20.0%
14	Assessment Value (Line 12 * Line 13)	237,784	\$ 264,797
15	Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16)	7.4558%	7.4558%
16	Property Tax Expense - Excludes Parcels (Line 14 * Line 15)	\$ 17,729	\$ 19,743
17	Tax of Parcels	\$ 1,320	\$ 1,320
18	Staff Recommended Test Year Property Tax (Line 16 + Line 17)	\$ 19,049	
19	Company Proposed Property Tax	21,299	
20	Staff Test Year Adjustment (Line 18-Line 19)	\$ (2,250)	
21	Property Tax - Staff Recommended Revenue (Line 16 + Line 17)		\$ 21,063
22	Staff Test Year Adjusted Property Tax Expense (Line 18)		\$ 19,049
23	Increase/(Decrease) to Property Tax Expense Line 21 - Line 22)		\$ 2,014
24	Increase to Property Tax Expense		\$ 2,014
25	Increase in Revenue Requirement		202,604
26	Increase to Property Tax per Dollar Increase in Revenue (Line 24/Line 25)		0.994107%

References:

Col [A]: Company Schedule C-1 Page 3

Col [B]: GLF Testimony

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-18
Date: 9/12/11

OPERATING INCOME ADJUSTMENT # 6 - INCOME TAXES

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Income Tax	\$ 22,873	\$ (12,813)	\$ 10,060

References:

Col [A]: Company Schedule C-1 Page 3
Col [B]: Column [C] - Column [A]
Col [C]: Schedule GLF-2

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-18.1
Date: 9/12/11

OPERATING INCOME ADJUSTMENT # 7 - ANNUALIZE PURCHASED POWER

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Purchased Power	<u>\$ 27,066</u>	<u>\$ 577</u>	<u>\$ 27,643</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

RATE DESIGN

Monthly Usage Charge (all classes)	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" Meter - All Classes	\$ 42.20	\$ 56.97	\$ 51.00
3/4" Meter - All Classes	\$ 63.30	\$ 85.46	\$ 76.50
1" Meter - All Classes	\$ 105.50	\$ 142.43	\$ 128.00
1½" Meter - All Classes	\$ 211.50	\$ 284.85	\$ 255.00
2" Meter - All Classes	\$ 339.68	\$ 455.76	\$ 408.00
3" Meter - All Classes	\$ 675.20	\$ 911.52	\$ 816.00
4" Meter - All Classes	\$ 1,055.00	\$ 1,424.25	\$ 1,275.00
6" Meter - All Classes	\$ 2,110.00	\$ 2,848.50	\$ 2,550.00
Construction/Stand pipe	N/A	N/A	N/A
Commodity Rates (all classes)			
5/8" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 5.10
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 9,000 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
3/4" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 5.10
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 10,000 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
1" Meter			
From 1 to 22,500 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 22,500 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
1½" Meter			
From 1 to 34,000 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 34,000 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
2" Meter			
From 1 to 45,000 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 45,000 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
3" Meter			
From 1 to 68,000 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 68,000 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
4" Meter			
From 1 to 90,000 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 90,000 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
6" Meter (Res., Comm.)			
From 1 to 135,000 Gallons	\$ 5.91	\$ 10.92	\$ 10.40
Over 135,000 Gallons	\$ 7.11	\$ 13.13	\$ 12.40
Construction/Stand pipe (Res., Comm.)			
All Gallons	\$ 7.11	\$ 13.13	\$ 12.40

	Present	Co. Proposed			Staff Recommended		
Service Line and Meter Installation Charges	Total	Line	Meter	Total	Line	Meter	Total
5/8" Meter	\$ 225	\$ 385	\$ 135	\$ 520	\$ 385	\$ 135	\$ 520
3/4" Meter	270	415	205	620	415	205	620
1" Meter	300	465	265	730	465	265	730
1½" Meter	425	520	475	995	520	475	995
2" Turbine Meter	550	800	995	1,795	800	995	1,795
2" Compound Meter	550	800	1,840	2,640	800	1,840	2,640
3" Turbine Meter	750	1,015	1,620	2,635	1,015	1,620	2,635
3" Compound Meter	750	1,135	2,495	3,630	1,135	2,495	3,630
4" Turbine Meter	1,375	1,430	2,570	4,000	1,430	2,570	4,000
4" Compound Meter	1,375	1,610	3,545	5,155	1,610	3,545	5,155
6" Turbine Meter	2,800	2,150	4,925	7,075	2,150	4,925	7,075
6" Compound Meter	2,800	2,270	6,820	9,090	2,270	6,820	9,090
8"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
10"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
12"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
Service Charges							
Establishment	\$ 50.00	\$ 50.00			\$ 50.00		
Establishment (After Hours)	75.00	75.00			NT		
Reconnection (delinquent)	75.00	75.00			75.00		
Reconnection (after hours)	50.00	50.00			NT		
Meter Test	20.00	20.00			20.00		
Deposit Requirement (Residential)	(a)	(a)			(a)		
Deposit Requirement (None Residential Meter)	(a)	(a)			(a)		
Deposit Interest	6.00%	6.00%			6.00%		
Re-Establishment (Within 12 Months)	(b)	(b)			(b)		
NSF Check	15.00	15.00			15.00		
Deferred Payment, Per Month	1.5%	1.50%			1.50%		
Meter Re-Read	20.00	20.00			20.00		
Late Charge per month	1.5%	1.5%			1.5%		
Customer Requested Meter Test	20.00	20.00			20.00		
After Hours Service Charge	10.00	10.00			50.00		
Turn-on/off (at customer request)	NT	75.00			NT		
Moving Customer Meter (at customer request)	NT	cost			cost		
NT = No Tariff							
Monthly Service Charge for Fire Sprinkler							
All Meter Sizes		Greater of \$10 or 2 percent of the general service rate for a similar size meter.					

Per Commission Rules (R14-2-403.B)

- (a) Residential - two times the average bill. Non-residential - two and one-half times the average bill.
- (b) Minimum charge times number of months disconnected.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission Rule (14-2-409.D.5).
All advances and/or contributions are to include labor, materials, overheads and all applicable taxes,
Cost to include labor, materials and parts, overheads and all applicable taxes.

Typical Bill Analysis
Residential 5/8 Inch Meter

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	5,477	\$ 66.73	\$ 100.30	\$ 33.57	50.31%
Median Usage	4,500	60.96	89.63	\$ 28.68	47.04%

Staff Recommended

Average Usage	5,477	\$ 66.73	\$ 92.06	\$ 25.33	37.96%
Median Usage	4,500	60.96	81.90	\$ 20.95	34.36%

Present & Proposed Rates (Without Taxes)
Residential 5/8 Inch Meter

Consumption	Rates	Rates	Increase	Rates	Increase
-	\$ 42.20	\$ 56.97	35.00%	\$ 51.00	20.85%
1,000	46.15	63.77	38.18%	56.10	21.56%
2,000	50.10	70.57	40.86%	61.20	22.16%
3,000	54.05	77.37	43.15%	66.30	22.66%
4,000	58.00	84.17	45.12%	76.70	32.24%
4,500	60.96	89.63	47.04%	81.90	34.36%
5,000	63.91	95.09	48.79%	87.10	36.29%
5,477	66.73	100.30	50.31%	92.06	37.96%
6,000	69.82	106.01	51.83%	97.50	39.64%
7,000	75.73	116.93	54.40%	107.90	42.48%
8,000	81.64	127.85	56.60%	118.30	44.90%
9,000	87.55	138.77	58.50%	128.70	47.00%
10,000	94.66	151.90	60.47%	141.10	49.06%
11,000	101.77	165.03	62.16%	153.50	50.83%
12,000	108.88	178.16	63.63%	165.90	52.37%
13,000	115.99	191.29	64.92%	178.30	53.72%
14,000	123.10	204.42	66.06%	190.70	54.91%
15,000	130.21	217.55	67.08%	203.10	55.98%
16,000	137.32	230.68	67.99%	215.50	56.93%
17,000	144.43	243.81	68.81%	227.90	57.79%
18,000	151.54	256.94	69.55%	240.30	58.57%
19,000	158.65	270.07	70.23%	252.70	59.28%
20,000	165.76	283.20	70.85%	265.10	59.93%
25,000	201.31	348.85	73.29%	327.10	62.49%
30,000	236.86	414.50	75.00%	389.10	64.27%
35,000	272.41	480.15	76.26%	451.10	65.60%
40,000	307.96	545.80	77.23%	513.10	66.61%
45,000	343.51	611.45	78.00%	575.10	67.42%
50,000	379.06	677.10	78.63%	637.10	68.07%
75,000	556.81	1,005.35	80.56%	947.10	70.09%
100,000	734.56	1,333.60	81.55%	1,257.10	71.14%

TESTIMONY - GORDON L. FOX

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GLF-18.1	OPERATING INCOME ADJUSTMENT # 7 - ANNUALIZE PURCHASED POWER
GLF-19	RATE DESIGN
GLF-20	TYPICAL BILL ANALYSIS

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY FAIR VALUE	(C) STAFF ORIGINAL COST	(D) STAFF FAIR VALUE
1	Adjusted Rate Base	\$ 2,402,222	\$ 2,402,222	\$ 2,077,253	\$ 2,077,253
2	Adjusted Operating Income (Loss)	\$ 73,882	\$ 73,882	\$ 71,259	\$ 71,259
3	Current Rate of Return (L2 / L1)	3.08%	3.08%	3.43%	3.43%
4	Required Rate of Return	10.54%	10.54%	5.59%	5.59%
5	Required Operating Income (L4 * L1)	\$ 253,194	\$ 253,194	\$ 116,041	\$ 116,041
6	Operating Income Deficiency (L5 - L2)	\$ 179,312	\$ 179,312	\$ 44,782	\$ 44,782
7	Gross Revenue Conversion Factor	1.6254	1.6254	1.5408	1.5408
8	Required Revenue Increase (L7 * L6)	\$ 291,454	\$ 291,454	\$ 69,000	\$ 69,000
9	Adjusted Test Year Revenue	\$ 572,751	\$ 572,751	\$ 594,459	\$ 594,459
10	Proposed Annual Revenue (L8 + L9)	\$ 864,205	\$ 864,205	\$ 663,459	\$ 663,459
11	Required Increase in Revenue (%)	50.89%	50.89%	11.61%	11.61%
12	Rate of Return on Common Equity (%)	11.00%	11.00%		

References:

Column (A): Company Schedule B-1

Column (B): Company Schedule B-1

Column (C): Company Schedules A-1, A-2, & D-1

Column (D): Staff Schedule GLF-2 , GLF-3 & GLF-11

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.0000%			
3	Revenues (L1 - L2)	100.0000%			
4	Combined Federal and State Tax Rate (Line 17) + Property Tax Factor (Line 23)	35.0986%			
5	Subtotal (L3 - L4)	64.9014%			
6	Revenue Conversion Factor (L1 / L5)	1.5408			
<u>Calculation of Uncollectible Factor:</u>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	34.4469%			
9	One Minus Combined Income Tax Rate (L7 - L8)	65.5531%			
10	Uncollectible Rate	0.0000%			
11	Uncollectible Factor (L9 * L10)	0			
<u>Calculation of Effective Tax Rate:</u>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	6.9680%			
14	Federal Taxable Income (L12 - L13)	93.0320%			
15	Applicable Federal Income Tax Rate (Line 53)	29.5370%			
16	Effective Federal Income Tax Rate (L14 * L15)	0.274789067			
17	Combined Federal and State Income Tax Rate (L13 + L16)	34.4469%			
<u>Calculation of Effective Property Tax Factor</u>					
18	Unity	100.0000%			
19	Combined Federal and State Tax Rate (Line 17)	34.4469%			
20	One Minus Combined Income Tax Rate (L18 - L19)	65.5531%			
21	Property Tax Factor (GLF-17, L26)	0.9941%			
22	Effective Property Tax Factor (L 21 * L 22)	0.6517%			
23	Combined Federal and State Tax and Property Tax Rate (L17+L22)		35.0986%		
24	Required Operating Income (Schedule GLF-1, Line 5)	\$ 116,041			
25	Adjusted Test Year Operating Income (Loss) (Schedule GLF-11, Line 33)	\$ 71,259			
26	Required Increase in Operating Income (L24 - L25)		\$ 44,782		
27	Income Taxes on Recommended Revenue (Col. (D), L52)	\$ 33,592			
28	Income Taxes on Test Year Revenue (Col. (B), L52)	\$ 10,060			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		\$ 23,532		
30	Recommended Revenue Requirement (Schedule GLF-1, Line 10)	\$ 663,459			
31	Uncollectible Rate (Line 10)	0.0000%			
32	Uncollectible Expense on Recommended Revenue (L24 * L25)	\$ -			
33	Adjusted Test Year Uncollectible Expense	\$ -			
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32 - L33)		\$ -		
35	Property Tax with Recommended Revenue (GLF-17, L21)	\$ 19,735			
36	Property Tax on Test Year Revenue (GLF-17, L22)	\$ 19,049			
37	Increase in Property Tax Due to Increase in Revenue (GLF-17, L23)		\$ 686		
38	Total Required Increase in Revenue (L26 + L29 + L34+L37)		\$ 69,000		
<u>Calculation of Income Tax:</u>					
		Test Year	STAFF Recommended		
39	Revenue (Schedule GLF-11, Col.[C], Line 5 & Sch. GLF-1, Col. [D], Line 10)	\$ 594,459	\$ 663,459		
40	Operating Expenses Excluding Income Taxes	\$ 513,139	\$ 513,825		
41	Synchronized Interest (L56)	\$ 33,236	\$ 33,236		
42	Arizona Taxable Income (L39 - L40- L41)	\$ 48,083	\$ 116,398		
43	Arizona State Income Tax Rate	6.9680%	6.9680%		
44	Arizona Income Tax (L42 x L43)	\$ 3,350	\$ 8,111		
45	Federal Taxable Income (L42 - L44)	\$ 44,733	\$ 108,287		
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ 6,710	\$ 7,500		
47	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	\$ -	\$ 6,250		
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -	\$ 8,500		
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -	\$ 3,232		
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -	\$ -		
51	Total Federal Income Tax	\$ 6,710	\$ 25,482		
52	Combined Federal and State Income Tax (L44 + L51)	\$ 10,060	\$ 33,592		
53	Applicable Federal Income Tax Rate [Col. (D), L51 - Col. (B), L51] / [Col. (C), L44 - Col. (A), L44]				29.54%
<u>Calculation of Interest Synchronization:</u>					
54	Rate Base (Schedule GLF-3, Col. [C], Line (14))	\$ 2,077,253			
55	Weighted Average Cost of Debt (Surrebuttal Schedule JCM-1)	1.60%			
56	Synchronized Interest (L54 X L55)	\$ 33,236			

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	REF	(C) STAFF AS ADJUSTED
1	Plant in Service	\$ 5,453,761	\$ (487,242)	\$ 4,966,519
2	Less: Accumulated Depreciation	731,205	16,013	747,218
3	Net Plant in Service	<u>\$ 4,722,556</u>	<u>\$ (503,255)</u>	<u>\$ 4,219,301</u>
<u>LESS:</u>				
4	Contributions in Aid of Construction (CIAC)	\$ -	\$ -	\$ -
5	Less: Accumulated Amortization	-	-	-
6	Net CIAC	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
7	Advances in Aid of Construction (AIAC)	2,101,905	(128,600)	1,973,305
8	Service Line & Meter Installation Charges	83,087	-	83,087
9	Deferred Income Tax Credits	135,342	(49,686)	85,656
<u>ADD:</u>				
10	Unamortized Finance Charges	-	-	-
11	Deferred Tax Assets	-	-	-
12	Working Capital	-	-	-
13	Intentionally Left Blank	-	-	-
14	Original Cost Rate Base	<u>\$ 2,402,222</u>	<u>\$ (324,969)</u>	<u>\$ 2,077,253</u>

References:

Column (A), Company Schedule B-1
Column [B]: Column [C] - Column [A]
Column [C], GLF-4

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	ACCT. NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) LAND ADJ.#1	(C) WATER TREATMENT ADJ.#2	(D) DISTRIBUTION RESERVOIR ADJ.#3	(E) DISTRIBUTION RESERVOIR ADJ.#4	(F) TRANSMISSION MAINS ADJ.#5	(G) DEPRECIATION ADJ.#6	(C) AIAC ADJ.#7	(I) ADIT ADJ.#8	(J) STAFF ADJUSTED
PLANT IN SERVICE:												
1	301	Organization Cost	\$ 127,103	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 127,103
2	302	Franchise Cost	-	-	-	-	-	-	-	-	-	-
3	303	Land and Land Rights	494,159	(472,521)	-	-	-	-	-	-	-	21,638
4	304	Structures and Improvements	182,570	186,229	-	-	-	-	-	-	-	368,799
5	305	Collecting and Impounding Res.	-	-	-	-	-	-	-	-	-	-
6	306	Lake River and other Intakes	-	-	-	-	-	-	-	-	-	-
7	307	Wells and Springs	386,591	-	-	-	-	-	-	-	-	386,591
8	308	Infiltration Galleries and Tunnels	-	-	-	-	-	-	-	-	-	-
9	309	Supply Mains	-	-	-	-	-	-	-	-	-	-
10	310	Power Generation Equipment	-	-	-	-	-	-	-	-	-	-
11	311	Electrical Pumping Equipment	968,652	-	-	-	-	-	-	-	-	968,652
12	320	Water Treatment Equipment	15,947	-	(15,947)	-	-	-	-	-	-	-
13	320.1	Water Treatment Plant	-	-	-	-	-	-	-	-	-	-
14	320.2	Chemical Solution Feeders	-	-	15,947	-	-	-	-	-	-	-
15	330	Distribution Reservoirs & Standpipe	836,890	-	-	(836,890)	-	-	-	-	-	15,947
16	330.1	Storage Tanks	-	-	-	384,827	(72,350)	-	-	-	-	312,477
17	330.2	Pressure Tanks	-	-	-	452,063	-	-	-	-	-	452,063
18	331	Transmission and Distribution Mains	1,611,320	-	-	-	-	(128,600)	-	-	-	1,482,720
19	333	Services	386,947	-	-	-	-	-	-	-	-	386,947
20	334	Meters	94,263	-	-	-	-	-	-	-	-	94,263
21	335	Hydrants	161,737	-	-	-	-	-	-	-	-	161,737
22	336	Backflow Prevention Devices	-	-	-	-	-	-	-	-	-	-
23	339	Other Plant & Miscellaneous Equipment	187,582	-	-	-	-	-	-	-	-	187,582
24	340	Office Furniture & Fixtures	-	-	-	-	-	-	-	-	-	-
25	340.1	Computers & Software	-	-	-	-	-	-	-	-	-	-
26	341	Transportation Equipment	-	-	-	-	-	-	-	-	-	-
27	342	Stores Equipment	-	-	-	-	-	-	-	-	-	-
28	343	Tools and Work Equipment	-	-	-	-	-	-	-	-	-	-
29	344	Laboratory Equipment	-	-	-	-	-	-	-	-	-	-
30	345	Power Operated Equipment	-	-	-	-	-	-	-	-	-	-
31	346	Communications Equipment	-	-	-	-	-	-	-	-	-	-
32	347	Miscellaneous Equipment	-	-	-	-	-	-	-	-	-	-
33	348	Other Tangible Plant	-	-	-	-	-	-	-	-	-	-
34		Rounding Amount	\$ 5,453,761	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ 16,013	\$ -	\$ -	\$ 4,966,519
35		Subtotal Plant In Service										
36		Add:										
37	Other 1	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
38	Other 2	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
39	Less:											
40	Other 3	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
41	Other 4	Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
42												
43		Total Plant In Service:	\$ 5,453,761	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ 16,013	\$ -	\$ -	\$ 4,966,519
44		Less: Accumulated Depreciation	731,205	-	-	-	-	-	-	-	-	747,218
45		Intentionally Left Blank	-	-	-	-	-	-	-	-	-	-
46		Net Plant In Service (L59 - L 60)	\$ 4,722,556	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ (16,013)	\$ -	\$ -	\$ 4,219,301
47												
48		LESS:										
49		Contributions in Aid of Construction (CIAC)	-	-	-	-	-	-	-	-	-	-
50		Less: Accumulated Amortization	-	-	-	-	-	-	-	-	-	-
51		Net CIAC (L49 - L50)	-	-	-	-	-	-	-	-	-	-
52		Advances in Aid of Construction (AIAC)	2,101,905	-	-	-	-	-	-	(128,600)	-	1,973,305
53		Service Line & Meter Installation Charges	83,087	-	-	-	-	-	-	-	-	83,087
54		Deferred Income Tax Credit	135,342	-	-	-	-	-	-	-	(49,686)	85,656
55												
56		ADD:										
57		Unamortized Finance Charges	-	-	-	-	-	-	-	-	-	-
58		Deferred Tax Assets	-	-	-	-	-	-	-	-	-	-
59		Working Capital	-	-	-	-	-	-	-	-	-	-
60		Regulatory Asset (Liability)	-	-	-	-	-	-	-	-	-	-
61		Original Cost Rate Base	\$ 2,402,222	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ (16,013)	\$ 128,600	\$ 49,686	\$ 2,077,253

References:
Column [A] Schedule B-2, E-1

ORIGINAL COST RATE BASE ADJUSTMENT # 1 - LAND PURCHASE

LINE NO.	Description	Account Number	COMPANY PROPOSED	STAFF ADJUSTMENTS	STAFF RECOMMENDED		
1	Land and Land Rights	303	\$ 494,159	\$ (472,521)	\$ 21,638		
2	Structures & Improvements	304	\$ 182,570	\$ 186,229	\$ 368,799		
			Plant 1 0.72 Acres	Plant 2 0.25 Acres	Plant 4 0.39 Acres	Plant 3 0.63 Acres	Total 1.99 Acres
Land:							
3	Purchase Price (467.155 Acres)	\$ 4,103,318	\$ 6,324	\$ 2,196	\$ 3,426	\$ 5,534	\$ 17,479
4	Closing Costs						\$ 2,159
5	Appraisal Fee						\$ 2,000
6	Total Land						<u>\$ 21,638</u>
Structures and Improvements:							
7	GRA Improvements 4/15/85 to 6/12/01	\$ 795,363	\$ 1,226	\$ 426	\$ 664	\$ 1,073	\$ 3,388
8	Phase I Development Costs (68.93 Acres)	\$ 7,283,576	76,080	26,417	-	-	\$ 102,496
9	Phase III Development Costs (43.66 Acres)	\$ 2,284,877	-	-	20,410	-	\$ 20,410
10	Phase IV Development Costs (95.705 Acres)	\$ 9,104,785	-	-	-	59,934	\$ 59,934
11	Total Add'l Structures and Improvements		<u>\$ 77,306</u>	<u>\$ 26,842</u>	<u>\$ 21,074</u>	<u>\$ 61,007</u>	<u>\$ 186,229</u>
Accumulated Depreciation - Structures and Improvements - Book:							
In Service Date:			5/1/02	8/1/05	1/1/08	10/1/08	
12	Depreciation Basis (Line 11)		\$ 77,306	\$ 26,842	\$ 21,074	\$ 61,007	\$ 186,229
13	Depreciation - 2002 (2.5%)		966				966
14	Depreciation - 2003 (2.5%)		1,933				1,933
15	Depreciation - 2004 (2.5%)		1,933				1,933
16	Depreciation - 2005 (2.5%)		1,933	336			2,268
17	Depreciation - 2006 (2.5%)		1,933	671			2,604
18	Depreciation - 2007 (2.5%*4/12) +(3.33%*8/12) ¹		2,360	820			3,180
19	Depreciation - 2008 (3.33%)		2,574	894	351	1,016	4,835
20	Depreciation - 2009 (3.33%) - Test Year		2,574	894	702	2,035	6,204
21	Accumulated Depreciation (Sum Lines 13 thru 20) ²		<u>\$ 16,206</u>	<u>\$ 3,614</u>	<u>\$ 1,053</u>	<u>\$ 3,050</u>	<u>\$ 23,923</u>

¹ Depreciation rate changed from 2.5% to 3.33% May 1, 2007.

² \$23,923 adjustment to A/D is reflected in GLF-10, Line 2.

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Schedule GLF-6
Phase 1

ORIGINAL COST RATE BASE ADJUSTMENT # 2 - RECLASSIFY WATER TREATMENT EQUIPMENT

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	320	Water Treatment Equipment	\$ 15,947	\$ (15,947)	\$ -
2	320.1	Water Treatment Plant		-	-
3	320.2	Chemical Solution Feeders		\$ 15,947	\$ 15,947
4		Total	<u>\$ 15,947</u>	<u>\$ -</u>	<u>\$ 15,947</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony , SDR GTM-1.5
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-7
Phase 1

ORIGINAL COST RATE BASE ADJUSTMENT # 3 - RECLASSIFY DISTRIBUTION RESERVOIRS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	330	Distribution Reservoirs & Standpipe	\$ 836,890	\$ (836,890)	\$ -
2	330.1	Storage Tanks		\$ 384,827	\$ 384,827
3	330.2	Pressure Tanks		\$ 452,063	\$ 452,063
4		Total	<u>\$ 836,890</u>	<u>\$ -</u>	<u>\$ 836,890</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony, SDR GTM-1.4

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-8
Phase 1

ORIGINAL COST RATE BASE ADJUSTMENT # 4 - ELIMINATE EXCESS CAPACITY - STORAGE TANK

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	331	Storage Tanks ¹	\$ 384,827	\$ (72,350)	\$ 312,477

¹ The Company proposed amount is the portion claimed by the Company and reclassified by Staff to Acct. 330.1 as shown in GTM-7.

References:

Col [A]: Company Schedule B-1
Col [B]: GLF and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-9
Phase 1

ORIGINAL COST RATE BASE ADJUSTMENT # 5 - ELIMINATE EXCESS CAPACITY - DISTRIBUTION MAINS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	333	Transmission and Distribution Mains	<u>1,611,320</u>	<u>\$ (128,600)</u>	<u>\$ 1,482,720</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

ORIGINAL COST RATE BASE ADJUSTMENT # 6 - ADJUST ACCUMULATED DEPRECIATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Depreciation	\$ 731,205	\$ 16,013	\$ 747,218
			Accumulated Depreciation per application	Accumulated Depreciation per Staff	Difference
2		Structures and Improvements	\$ 10,285	\$ 34,208	\$ 23,923
3		Collecting and Impounding Res.	-	-	-
4		Lake River and other Intakes	-	-	-
5		Wells and Springs	67,423	67,423	0
6		Infiltration Galleries and Tunnels	-	-	-
7		Supply Mains	-	-	-
8		Power Generation Equipment	-	-	-
9		Electrical Pumping Equipment	341,101	341,101	0
10		Water Treatment Equipment	2,167	0	(2,167)
11		Water Treatment Plant	-	-	-
12		Chemical Solution Feeders	-	2,167	2,167
13		Distribution Reservoirs & Standpipe	64,318	-	(64,318)
14		Storage Tanks	-	27,712	27,712
15		Pressure Tanks	-	32,553	32,553
16		Transmission and Distribution Mains	139,059	135,201	(3,858)
17		Services	40,947	40,947	-
18		Meters	17,066	17,066	-
19		Hydrants	12,984	12,984	-
20		Backflow Prevention Devices	-	-	-
21		Other Plant & Miscellaneous Equipment	35,847	35,847	-
22		Office Furniture & Fixtures	-	-	-
23		Computers & Software	-	-	-
24		Transportation Equipment	-	-	-
25		Stores Equipment	-	-	-
26		Tools and Work Equipment	-	-	-
27		Laboratory Equipment	-	-	-
28		Power Operated Equipment	-	-	-
29		Communications Equipment	-	-	-
30		Miscellaneous Equipment	-	-	-
31		Other Tangible Plant	-	-	-
			\$ 731,197	\$ 747,210	\$ 16,013

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony, RUCO DR 2.12
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-10.1
Phase 1

ORIGINAL COST RATE BASE ADJUSTMENT # 7 - REDUCE AIAC

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	108	AIAC	<u>2,101,905</u>	<u>\$ (128,600)</u>	<u>\$ 1,973,305</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-10.2
Phase 1

ORIGINAL COST RATE BASE ADJUSTMENT # 8 - ACCUMULATED DEFERRED INCOME TAX

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Deferred Income Tax	135,342	\$ (49,686)	\$ 85,656

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

ADIT Calculation

	Adj Book Value	Tax Value	Realization Probability	Expected Realized (Taxable TD) Deductible TD	Tax Rate	Future Tax Asset Current	Non-current	Future Tax Liability Current	Non-current
PIS	4,966,519								
A/D	(747,218)								
CIAC	(1,381,314)								
Total/ Fixed Assets	2,837,988	2,019,279	100%	(818,709)	37.8%				(309,316)
AIAC		1,973,305	30%	591,992	37.8%		223,660		
Totals						-	223,660	-	(309,316)

ADIT Net Asset (Liability) - Staff	(85,656)
ADIT Net Asset (Liability) Company as Filed	(135,342)
Staff Adjustment	49,686

Computation of Net Tax Value at Dec. 31, 2009:

Unadjusted Cost per 2009 Tax Deprec Report	4,938,108
Reconciling Items not on tax report	
Net Structures and Improvement to Land not on tax, used in rates	162,306
Adjusted land costs not on tax, on books (Staff adjusted Land Value)	21,638
Net Unadjusted Cost Tax Basis	5,122,053

Basis Reductions/Additions:

Basis reduction 2009 and prior years	(14,706)
Advance or Contr plant with no deprec basis listed on 2009 Tax Deprec Report	(2,707,816)
Accumulated Depreciation 2008 and prior (2009 Tax Deprec Report)	(339,352)
Upsizing Adjustment - Tank	(72,350)
Tax Depreciation related to Tank Upsizing	4,341
Excess Capacity - Mains	128,600
Tax Depreciation related to Excess Capacity - Mains (2008) (AIAC no depr)	-
2009 Current Year Tax Depreciation	(101,491)
Net Basis Reduction 2007 and Prior years	(3,102,774)
Net tax value of PIS at Dec. 31, 2008	2,019,279

CIAC (including impact of change to probability of realization)

Gross CIAC (Schedule B-2)	-
Less: Pre-1996 CIAC	-
A.A.	-
A.A. on Pre-1996	-
A.A. on Post 1996 CIAC	-
Net CIAC before unrealized AIAC	-

Unrealized AIAC Component:

Adjusted Net AIAC	1,973,305
AIAC funding Mains	-
Sub-total	1,973,305
Unrealized AIAC Component % (1-Realized AIAC Component)	70%
	1,381,314
Total Realizable CIAC	1,381,314

AIAC (including impact of change to probability of realization)

AIAC (Schedule B-2)	1,973,305
Less: Pre-1996 AIAC included for book and tax purposes	-
Net AIAC before unrealized portion	1,973,305
Less: Unrealized AIAC from above	(1,381,314)
Net Realizable AIAC	591,992

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OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

LINE NO.	DESCRIPTION	[A] COMPANY ADJUSTED TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
1	<u>OPERATING REVENUES:</u>					
2	Metered Water Revenues	\$ 559,013	\$ 21,708	\$ 580,721	\$ 69,000	\$ 649,721
3	Unmetered Water Revenues	-	-	-	-	-
4	Other Water Revenues	13,738	-	13,738	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ 594,459	\$ 69,000	\$ 663,459
6	<u>OPERATING EXPENSES:</u>					
7	Salaries and Wages	\$ 40,000	-	\$ 40,000	-	\$ 40,000
8	Employee Pensions & Benefits	-	-	-	-	-
9	Purchased Water	-	-	-	-	-
10	Purchased Power	27,066	577	27,643	-	27,643
11	Chemicals	-	-	-	-	-
12	Repairs and Maintenance	7,746	-	7,746	-	7,746
13	Office Supplies and Expense	14,855	-	14,855	-	14,855
14	Outside Services	102,925	-	102,925	-	102,925
15	Water Testing	1,215	1,568	2,783	-	2,783
16	Rents	-	-	-	-	-
17	Transportation Expenses	-	-	-	-	-
18	Insurance - General Liability	9,669	-	9,669	-	9,669
19	Insurance - Health and Life	-	-	-	-	-
20	Advertising	-	-	-	-	-
21	Regulatory Comm Expense - Rate Case	20,000	20,000	40,000	-	40,000
22	Regulatory Comm Expense - Other	378	-	378	-	378
23	Bad Debt Expense	-	-	-	-	-
24	Miscellaneous Expense	-	-	-	-	-
25	Depreciation and Amortization	227,855	17,249	245,104	-	245,104
26	Interest on Security Deposits	-	-	-	-	-
27	Taxes other than Income	2,988	-	2,988	-	2,988
28	Property Taxes	21,299	(2,250)	19,049	686	19,735
29	Income Tax	22,873	(12,813)	10,060	23,532	33,592
30	Total Operating Expenses	\$ 498,869	\$ 24,331	\$ 523,200	\$ 24,218	\$ 547,418
31						
32	Operating Income	\$ 73,882	\$ (2,623)	\$ 71,259	\$ 44,782	\$ 116,041
33						

References:

Column [A]: Company Schedule C-1
Column [B]: Schedule GLF-12
Column [C]: Column [A] + Column [B]
Column [D]: Schedules GLF-1 and GLF-2
Column [E]: Column [C] + Column [D]

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SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] GLF-13 Revenue Annualization ADJ #1	[C] GLF-14 Rate Case Exp ADJ #2	[D] GLF-15 Water Testing ADJ #3	[E] GLF-16 Depreciation Exp ADJ #4	[F] GLF-17 Property Taxes ADJ #5	[G] GLF-18 Income Taxes ADJ #6	[H] GLF-18.1 An Pur Pwr ADJ #7	[I] STAFF ADJUSTED
1	<u>Operating Revenues:</u>									
2	Metered Water Revenues	\$ 559,013	\$ 21,708		\$ -	\$ -	\$ -	\$ -	\$ -	\$ 580,721
3	Unmetered Water Revenues	-	-		-	-	-	-	-	-
4	Other Water Revenues	13,738	-		-	-	-	-	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 594,489
6										
7	<u>Operating Expenses:</u>									
8	Salaries and Wages	\$ 40,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	40,000
9	Employee Pensions & Benefits	-	-	-	-	-	-	-	-	-
10	Purchased Water	-	-	-	-	-	-	-	-	-
11	Purchased Power	27,066	-	-	-	-	-	-	577	27,643
12	Chemicals	-	-	-	-	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	-	-	-	-	-	-	7,746
14	Office Supplies and Expense	14,855	-	-	-	-	-	-	-	14,855
15	Outside Services	102,925	-	-	-	-	-	-	-	102,925
16	Water Testing	1,215	-	-	1,568	-	-	-	-	2,783
17	Rents	-	-	-	-	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-	-	-	-	-
19	Insurance - General Liability	9,669	-	-	-	-	-	-	-	9,669
20	Insurance - Health and Life	-	-	-	-	-	-	-	-	-
21	Advertising	-	-	-	-	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	-	20,000	-	-	-	-	-	40,000
23	Regulatory Comm Expense - Other	378	-	-	-	-	-	-	-	378
24	Bad Debt Expense	-	-	-	-	-	-	-	-	-
25	Miscellaneous Expense	-	-	-	-	-	-	-	-	-
26	Depreciation and Amortization	227,855	-	-	-	17,249	-	-	-	245,104
27	Interest on Security Deposits	-	-	-	-	-	-	-	-	-
28	Taxes other than Income	2,988	-	-	-	-	-	-	-	2,988
29	Property Taxes	21,299	-	-	-	-	(2,250)	-	-	19,049
30	Income Tax	22,873	-	-	-	-	-	(12,813)	-	10,060
31	Total Operating Expenses	\$ 498,869	\$ -	\$ 20,000	\$ 1,568	\$ 17,249	\$ (2,250)	\$ (12,813)	\$ 577	\$ 523,200
	Operating Income	\$ 73,882	\$ 21,708	\$ (20,000)	\$ (1,568)	\$ (17,249)	\$ 2,250	\$ 12,813	\$ (577)	\$ 71,259

References:
Column [A]: Company Schedule C-1
Column [B] - [G]: Schedule GTM-13 through GTM-17
Column [C]: Add Column [A] - Column [F]

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Schedule GLF-13
Phase 1

OPERATING INCOME ADJUSTMENT # 1 - REVENUE ANNUALIZATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Metered Water Revenues	<u>\$ 559,013</u>	<u>\$ 21,708</u>	<u>\$ 580,721</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-14
Phase 1

OPERATING INCOME ADJUSTMENT # 2 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Regulatory Commission Expense - Rate Case	\$ 20,000	\$ 20,000	\$ 40,000

References:

Column [A]: Company Schedule C-1

Column [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-15
Phase 1

OPERATING INCOME ADJUSTMENT # 3 - WATER TESTING EXPENSE

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Water Testing	\$ 1,215	\$ 1,568	\$ 2,783

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

OPERATING INCOME ADJUSTMENT # 4 - DEPRECIATION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Depreciation and Amortization	\$ 227,855	\$ 17,249	\$ 245,104

Line No.	ACCT NO.	DESCRIPTION	[A] Company Proposed PLANT IN SERVICE BALANCE	[B] STAFF DEPR. PLANT BALANCE	[C] STAFF RECOMMENDED RATE	[D] STAFF RECOMMENDED EXPENSE
Plant In Service						
2	301	Organization Cost	\$ 127,103	127,103	0.00%	\$ -
3	302	Franchise Cost	-	-	0.00%	-
4	303	Land and Land Rights	494,159	21,638	0.00%	-
5	304	Structures and Improvements	182,570	368,799	3.33%	12,281
6	305	Collecting and Impounding Res.	-	-	2.50%	-
7	306	Lake River and other Intakes	-	-	2.50%	-
8	307	Wells and Springs	386,591	386,591	3.33%	12,873
9	308	Infiltration Galleries and Tunnels	-	-	6.67%	-
10	309	Supply Mains	-	-	2.00%	-
11	310	Power Generation Equipment	-	-	5.00%	-
12	311	Electrical Pumping Equipment	968,652	968,652	12.50%	121,082
13	320.0	Water Treatment Equipment	15,947	-	-	-
14	320.1	Water Treatment Plant	-	-	3.33%	-
15	320.2	Chemical Solution Feeders	-	15,947	20.00%	3,189
16	330	Distribution Reservoirs & Standpipe	836,890	-	-	-
17	330	Storage Tanks	-	312,477	2.22%	6,937
18	330	Pressure Tanks	-	452,063	5.00%	22,603
19	331	Transmission and Distribution Mains	1,611,320	1,482,720	2.00%	29,654
20	333	Services	386,947	386,947	3.33%	12,885
21	334	Meters	94,263	94,263	8.33%	7,852
22	335	Hydrants	161,737	161,737	2.00%	3,235
23	336	Backflow Prevention Devices	-	-	6.67%	-
24	339	Other Plant & Miscellaneous Equipment	187,582	187,582	6.67%	12,512
25	340	Office Furniture & Fixtures	-	-	6.67%	-
26	340	Computers & Software	-	-	20.00%	-
27	341	Transportation Equipment	-	-	20.00%	-
28	342	Stores Equipment	-	-	4.00%	-
29	343	Tools and Work Equipment	-	-	5.00%	-
30	344	Laboratory Equipment	-	-	10.00%	-
31	345	Power Operated Equipment	-	-	5.00%	-
32	346	Communications Equipment	-	-	10.00%	-
33	347	Miscellaneous Equipment	-	-	10.00%	-
34	348	Other Tangible Plant	-	-	3.33%	-
35	-	Rounding Amount	-	-	67.00%	-
36		Subtotal General	\$ 5,453,761	\$ 4,966,519		\$ 245,104
37		Less: Non- depreciable Account(s)	621,262	148,741		
38		Depreciable Plant (L29-L30)	\$ 4,832,499	\$ 4,817,778		
39		Contributions-in-Aid-of-Construction (CIAC)			\$ -	
40		Weighted Average Depreciation/Amortization Rate			5.0875%	
41		Less: Amortization of CIAC (L32 x L33)				\$ -
42		Depreciation Expense - STAFF [Col. (C), L36 - L41]				\$ 245,104

OPERATING INCOME ADJUSTMENT # 5 - PROPERTY TAXES

LINE NO.	Property Tax Calculation	[A]		[B]	
		STAFF AS ADJUSTED		STAFF RECOMMENDED	
1	Staff Adjusted Test Year Revenues - 2009	\$	594,459	\$	594,459
2	Weight Factor		2		2
3	Subtotal (Line 1 * Line 2)	\$	1,188,918	\$	1,188,918
4a	Staff Adjusted Test Year Revenues - 2006		594,459		663,459
4b	Staff Recommended Revenue, Per Schedule GLF-1				
5	Subtotal (Line 4 + Line 5)	\$	1,783,377	\$	1,852,377
6	Number of Years		3		3
7	Three Year Average (Line 5 / Line 6)	\$	594,459	\$	617,459
8	Department of Revenue Multiplier		2		2
9	Revenue Base Value (Line 7 * Line 8)	\$	1,188,918	\$	1,234,918
10	Plus: 10% of CWIP -				-
11	Less: Net Book Value of Licensed Vehicles				-
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$	1,188,918	\$	1,234,918
13	Assessment Ratio		20.0%		20.0%
14	Assessment Value (Line 12 * Line 13)		237,784	\$	246,984
15	Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16)		7.4558%		7.4558%
16	Property Tax Expense - Excludes Parcels (Line 14 * Line 15)	\$	17,729	\$	18,415
17	Tax of Parcels	\$	1,320	\$	1,320
18	Staff Recommended Test Year Property Tax (Line 16 + Line 17)	\$	19,049		
19	Company Proposed Property Tax		21,299		
20	Staff Test Year Adjustment (Line 18-Line 19)	\$	(2,250)		
21	Property Tax - Staff Recommended Revenue (Line 16 + Line 17)			\$	19,735
22	Staff Test Year Adjusted Property Tax Expense (Line 18)			\$	19,049
23	Increase/(Decrease) to Property Tax Expense Line 21 - Line 22)			\$	686
24	Increase to Property Tax Expense			\$	686
25	Increase in Revenue Requirement				69,000
26	Increase to Property Tax per Dollar Increase in Revenue (Line 24/Line 25)				0.994107%

References:

Col [A]: Company Schedule C-1 Page 3
Col [B]: GLF Testimony

GOODMAN WATER COMPANY
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Test Year ended December 31, 2009

Schedule GLF-18
Phase 1

OPERATING INCOME ADJUSTMENT # 6 - INCOME TAXES

LINE NO.	DESCRIPTION	[A] COMPANY	[B] STAFF	[C] STAFF
		PROPOSED	ADJUSTMENTS	RECOMMENDED
1	Income Tax	\$ 22,873	\$ (12,813)	\$ 10,060

References:

Col [A]: Company Schedule C-1 Page 3

Col [B]: Column [C] - Column [A]

Col [C]: Schedule GLF-2

GOODMAN WATER COMPANY
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Schedule GLF-18.1
Phase 1

OPERATING INCOME ADJUSTMENT # 7 - ANNUALIZE PURCHASED POWER

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Purchased Power	\$ 27,066	\$ 577	\$ 27,643

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

RATE DESIGN

Monthly Usage Charge (all classes)	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" Meter - All Classes	\$ 42.20	\$ 56.97	\$ 42.50
3/4" Meter - All Classes	\$ 63.30	\$ 85.46	\$ 63.75
1" Meter - All Classes	\$ 105.50	\$ 142.43	\$ 106.00
1½" Meter - All Classes	\$ 211.50	\$ 284.85	\$ 213.00
2" Meter - All Classes	\$ 339.68	\$ 455.76	\$ 340.00
3" Meter - All Classes	\$ 675.20	\$ 911.52	\$ 680.00
4" Meter - All Classes	\$ 1,055.00	\$ 1,424.25	\$ 1,063.00
6" Meter - All Classes	\$ 2,110.00	\$ 2,848.50	\$ 2,125.00
Construction/Stand pipe	N/A	N/A	N/A
Commodity Rates (all classes)			
5/8" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.30
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 9,000 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
3/4" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.30
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 10,000 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
1" Meter			
From 1 to 22,500 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 22,500 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
1½" Meter			
From 1 to 34,000 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 34,000 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
2" Meter			
From 1 to 45,000 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 45,000 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
3" Meter			
From 1 to 68,000 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 68,000 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
4" Meter			
From 1 to 90,000 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 90,000 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
6" Meter (Res., Comm.)			
From 1 to 135,000 Gallons	\$ 5.91	\$ 10.92	\$ 8.70
Over 135,000 Gallons	\$ 7.11	\$ 13.13	\$ 10.50
Construction/Stand pipe (Res., Comm.)			
All Gallons	\$ 7.11	\$ 13.13	\$ 10.50

	Present	Co. Proposed			Staff Recommended		
Service Line and Meter Installation Charges	Total	Line	Meter	Total	Line	Meter	Total
5/8" Meter	\$ 225	\$ 385	\$ 135	\$ 520	\$ 385	\$ 135	\$ 520
3/4" Meter	270	415	205	620	415	205	620
1" Meter	300	465	265	730	465	265	730
1½" Meter	425	520	475	995	520	475	995
2" Turbine Meter	550	800	995	1,795	800	995	1,795
2" Compound Meter	550	800	1,840	2,640	800	1,840	2,640
3" Turbine Meter	750	1,015	1,620	2,635	1,015	1,620	2,635
3" Compound Meter	750	1,135	2,495	3,630	1,135	2,495	3,630
4" Turbine Meter	1,375	1,430	2,570	4,000	1,430	2,570	4,000
4" Compound Meter	1,375	1,610	3,545	5,155	1,610	3,545	5,155
6" Turbine Meter	2,800	2,150	4,925	7,075	2,150	4,925	7,075
6" Compound Meter	2,800	2,270	6,820	9,090	2,270	6,820	9,090
8"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
10"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
12"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
Service Charges							
Establishment	\$ 50.00	\$ 50.00			\$ 50.00		
Establishment (After Hours)	75.00	75.00			NT		
Reconnection (delinquent)	75.00	75.00			75.00		
Reconnection (after hours)	50.00	50.00			NT		
Meter Test	20.00	20.00			20.00		
Deposit Requirement (Residential)	(a)	(a)			(a)		
Deposit Requirement (None Residential Meter)	(a)	(a)			(a)		
Deposit Interest	6.00%	6.00%			6.00%		
Re-Establishment (With-in 12 Months)	(b)	(b)			(b)		
NSF Check	15.00	15.00			15.00		
Deferred Payment, Per Month	1.5%	1.50%			1.50%		
Meter Re-Read	20.00	20.00			20.00		
Late Charge per month	1.5%	1.5%			1.5%		
Customer Requested Meter Test	20.00	20.00			20.00		
After Hours Service Charge	10.00	10.00			50.00		
Turn-on/off (at customer request)	NT	75.00			NT		
Moving Customer Meter (at customer request)	NT	cost			cost		
NT = No Tariff							
Monthly Service Charge for Fire Sprinkler							
All Meter Sizes		Greater of \$10 or 2 percent of the general service rate for a similar size meter.					

Per Commission Rules (R14-2-403.B)

- (a) Residential - two times the average bill. Non-residential - two and one-half times the average bill.
- (b) Minimum charge times number of months disconnected.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission Rule (14-2-409.D.5).
All advances and/or contributions are to include labor, materials, overheads and all applicable taxes,
Cost to include labor, materials and parts, overheads and all applicable taxes.

Typical Bill Analysis
Residential 5/8 Inch Meter

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	5,477	\$ 66.73	\$ 100.30	\$ 33.57	50.31%
Median Usage	4,500	60.96	89.63	\$ 28.68	47.04%
Staff Recommended					
Average Usage	5,477	\$ 66.73	\$ 76.95	\$ 10.22	15.32%
Median Usage	4,500	60.96	68.45	\$ 7.49	12.30%

Present & Proposed Rates (Without Taxes)
Residential 5/8 Inch Meter

Consumption	Rates	Rates	Increase	Rates	Increase
-	\$ 42.20	\$ 56.97	35.00%	\$ 42.50	0.71%
1,000	46.15	63.77	38.18%	46.80	1.41%
2,000	50.10	70.57	40.86%	51.10	2.00%
3,000	54.05	77.37	43.15%	55.40	2.50%
4,000	58.00	84.17	45.12%	64.10	10.52%
4,500	60.96	89.63	47.04%	68.45	12.30%
5,000	63.91	95.09	48.79%	72.80	13.91%
5,477	66.73	100.30	50.31%	76.95	15.32%
6,000	69.82	106.01	51.83%	81.50	16.73%
7,000	75.73	116.93	54.40%	90.20	19.11%
8,000	81.64	127.85	56.60%	98.90	21.14%
9,000	87.55	138.77	58.50%	107.60	22.90%
10,000	94.66	151.90	60.47%	118.10	24.76%
11,000	101.77	165.03	62.16%	128.60	26.36%
12,000	108.88	178.16	63.63%	139.10	27.76%
13,000	115.99	191.29	64.92%	149.60	28.98%
14,000	123.10	204.42	66.06%	160.10	30.06%
15,000	130.21	217.55	67.08%	170.60	31.02%
16,000	137.32	230.68	67.99%	181.10	31.88%
17,000	144.43	243.81	68.81%	191.60	32.66%
18,000	151.54	256.94	69.55%	202.10	33.36%
19,000	158.65	270.07	70.23%	212.60	34.01%
20,000	165.76	283.20	70.85%	223.10	34.59%
25,000	201.31	348.85	73.29%	275.60	36.90%
30,000	236.86	414.50	75.00%	328.10	38.52%
35,000	272.41	480.15	76.26%	380.60	39.72%
40,000	307.96	545.80	77.23%	433.10	40.64%
45,000	343.51	611.45	78.00%	485.60	41.36%
50,000	379.06	677.10	78.63%	538.10	41.96%
75,000	556.81	1,005.35	80.56%	800.60	43.78%
100,000	734.56	1,333.60	81.55%	1,063.10	44.73%

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TESTIMONY - GORDON L. FOX

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REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY FAIR VALUE	(C) STAFF ORIGINAL COST	(D) STAFF FAIR VALUE
1	Adjusted Rate Base	\$ 2,402,222	\$ 2,402,222	\$ 2,077,253	\$ 2,077,253
2	Adjusted Operating Income (Loss)	\$ 73,882	\$ 73,882	\$ 71,259	\$ 71,259
3	Current Rate of Return (L2 / L1)	3.08%	3.08%	3.43%	3.43%
4	Required Rate of Return	10.54%	10.54%	6.52%	6.52%
5	Required Operating Income (L4 * L1)	\$ 253,194	\$ 253,194	\$ 135,425	\$ 135,425
6	Operating Income Deficiency (L5 - L2)	\$ 179,312	\$ 179,312	\$ 64,166	\$ 64,166
7	Gross Revenue Conversion Factor	1.6254	1.6254	1.6130	1.6130
8	Required Revenue Increase (L7 * L6)	\$ 291,454	\$ 291,454	\$ 103,500	\$ 103,500
9	Adjusted Test Year Revenue	\$ 572,751	\$ 572,751	\$ 594,459	\$ 594,459
10	Proposed Annual Revenue (L8 + L9)	\$ 864,205	\$ 864,205	\$ 697,959	\$ 697,959
11	Required Increase in Revenue (%)	50.89%	50.89%	17.41%	17.41%
12	Rate of Return on Common Equity (%)	11.00%	11.00%		

References:

Column (A): Company Schedule B-1

Column (B): Company Schedule B-1

Column (C): Company Schedules A-1, A-2, & D-1

Column (D): Staff Schedule GLF-2 , GLF-3 & GLF-11

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.0000%			
3	Revenues (L1 - L2)	100.0000%			
4	Combined Federal and State Tax Rate (Line 17) + Property Tax Factor (Line 23)	38.0039%			
5	Subtotal (L3 - L4)	61.9961%			
6	Revenue Conversion Factor (L1 / L5)	1.6130			
<u>Calculation of Uncollectible Factor:</u>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	37.3814%			
9	One Minus Combined Income Tax Rate (L7 - L8)	62.6186%			
10	Uncollectible Rate	0.0000%			
11	Uncollectible Factor (L9 * L10)	0			
<u>Calculation of Effective Tax Rate:</u>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	6.9680%			
14	Federal Taxable Income (L12 - L13)	93.0320%			
15	Applicable Federal Income Tax Rate (Line 53)	32.6914%			
16	Effective Federal Income Tax Rate (L14 x L15)	0.304134312			
17	Combined Federal and State Income Tax Rate (L13 + L16)	37.3814%			
<u>Calculation of Effective Property Tax Factor</u>					
18	Unity	100.0000%			
19	Combined Federal and State Tax Rate (Line 17)	37.3814%			
20	One Minus Combined Income Tax Rate (L18 - L19)	62.6186%			
21	Property Tax Factor (GLF-17, L26)	0.9941%			
22	Effective Property Tax Factor (L 21 * L 22)	0.6225%			
23	Combined Federal and State Tax and Property Tax Rate (L17+L22)		38.0039%		
24	Required Operating Income (Schedule GLF-1, Line 5)	\$ 135,425			
25	Adjusted Test Year Operating Income (Loss) (Schedule GLF-11, Line 33)	\$ 71,259			
26	Required Increase in Operating Income (L24 - L25)		\$ 64,166		
27	Income Taxes on Recommended Revenue (Col. (D), L52)	\$ 48,366			
28	Income Taxes on Test Year Revenue (Col. (B), L52)	\$ 10,060			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		\$ 38,305		
30	Recommended Revenue Requirement (Schedule GLF-1, Line 10)	\$ 697,959			
31	Uncollectible Rate (Line 10)	0.0000%			
32	Uncollectible Expense on Recommended Revenue (L24 * L25)	\$ -			
33	Adjusted Test Year Uncollectible Expense	\$ -			
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32 - L33)		\$ -		
35	Property Tax with Recommended Revenue (GLF-17, L21)	\$ 20,078			
36	Property Tax on Test Year Revenue (GLF-17, L22)	\$ 19,049			
37	Increase in Property Tax Due to Increase in Revenue (GLF-17, L23)		\$ 1,029		
38	Total Required Increase in Revenue (L26 + L29 + L34+L37)		\$ 103,500		
<u>Calculation of Income Tax:</u>					
39	Revenue (Schedule GLF-11, Col.(C), Line 5 & Sch. GLF-1, Col. (D), Line 10)	\$ 594,459			
40	Operating Expenses Excluding Income Taxes	\$ 513,139			
41	Synchronized Interest (L56)	\$ 33,236			
42	Arizona Taxable Income (L39 - L40- L41)	\$ 48,083			
43	Arizona State Income Tax Rate	6.9680%			
44	Arizona Income Tax (L42 x L43)		\$ 3,350		\$ 10,491
45	Federal Taxable Income (L42 - L44)	\$ 44,733			
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ 6,710			
47	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	\$ -			
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -			
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -			
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -			
51	Total Federal Income Tax		\$ 6,710		\$ 37,875
52	Combined Federal and State Income Tax (L44 + L51)		\$ 10,060		\$ 48,366
53	Applicable Federal Income Tax Rate [Col. (D), L51 - Col. (B), L51] / [Col. (C), L44 - Col. (A), L44]				32.69%
<u>Calculation of Interest Synchronization:</u>					
54	Rate Base (Schedule GLF-3, Col. (C), Line (14))	\$ 2,077,253			
55	Weighted Average Cost of Debt (Surrebuttal Schedule JCM-1)	1.60%			
56	Synchronized Interest (L54 X L55)	\$ 33,236			

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Schedule GLF-3
Phase 2

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	REF	(C) STAFF AS ADJUSTED
1	Plant in Service	\$ 5,453,761	\$ (487,242)	\$ 4,966,519
2	Less: Accumulated Depreciation	731,205	16,013	747,218
3	Net Plant in Service	<u>\$ 4,722,556</u>	<u>\$ (503,255)</u>	<u>\$ 4,219,301</u>
<u>LESS:</u>				
4	Contributions in Aid of Construction (CIAC)	\$ -	\$ -	\$ -
5	Less: Accumulated Amortization	-	-	-
6	Net CIAC	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
7	Advances in Aid of Construction (AIAC)	2,101,905	(128,600)	1,973,305
8	Service Line & Meter Installation Charges	83,087	-	83,087
9	Deferred Income Tax Credits	135,342	(49,686)	85,656
<u>ADD:</u>				
10	Unamortized Finance Charges	-	-	-
11	Deferred Tax Assets	-	-	-
12	Working Capital	-	-	-
13	Intentionally Left Blank	-	-	-
14	Original Cost Rate Base	<u>\$ 2,402,222</u>	<u>\$ (324,969)</u>	<u>\$ 2,077,253</u>

References:

Column (A), Company Schedule B-1
Column [B]: Column [C] - Column [A]
Column [C], GLF-4

**Schedule GILT-4
Phase 2**

References:
Column [A] Schedule B-2, E-1

References:
Column [A] Schedule B-2, E-1

ORIGINAL COST RATE BASE ADJUSTMENT # 1 - LAND PURCHASE

LINE NO.	Description	Account Number	COMPANY PROPOSED	STAFF ADJUSTMENTS	STAFF RECOMMENDED		
1	Land and Land Rights	303	\$ 494,159	\$ (472,521)	\$ 21,638		
2	Structures & Improvements	304	\$ 182,570	\$ 186,229	\$ 368,799		
			Plant 1 0.72 Acres	Plant 2 0.25 Acres	Plant 4 0.39 Acres	Plant 3 0.63 Acres	Total 1.99 Acres
Land:							
3	Purchase Price (467.155 Acres)	\$ 4,103,318	\$ 6,324	\$ 2,196	\$ 3,426	\$ 5,534	\$ 17,479
4	Closing Costs						\$ 2,159
5	Appraisal Fee						\$ 2,000
6	Total Land						\$ 21,638
Structures and Improvements:							
7	GRA Improvements 4/15/85 to 6/12/01	\$ 795,363	\$ 1,226	\$ 426	\$ 664	\$ 1,073	\$ 3,388
8	Phase I Development Costs (68.93 Acres)	\$ 7,283,576	76,080	26,417	-	-	\$ 102,496
9	Phase III Development Costs (43.66 Acres)	\$ 2,284,877	-	-	20,410	-	\$ 20,410
10	Phase IV Development Costs (95.705 Acres)	\$ 9,104,785	-	-	-	59,934	\$ 59,934
11	Total Add'l Structures and Improvements		\$ 77,306	\$ 26,842	\$ 21,074	\$ 61,007	\$ 186,229
Accumulated Depreciation - Structures and Improvements - Book:							
In Service Date:			5/1/02	8/1/05	1/1/08	10/1/08	
12	Depreciation Basis (Line 11)		\$ 77,306	\$ 26,842	\$ 21,074	\$ 61,007	\$ 186,229
13	Depreciation - 2002 (2.5%)		966				966
14	Depreciation - 2003 (2.5%)		1,933				1,933
15	Depreciation - 2004 (2.5%)		1,933				1,933
16	Depreciation - 2005 (2.5%)		1,933	336			2,268
17	Depreciation - 2006 (2.5%)		1,933	671			2,604
18	Depreciation - 2007 (2.5%*4/12) +(3.33%*8/12) ¹		2,360	820			3,180
19	Depreciation - 2008 (3.33%)		2,574	894	351	1,016	4,835
20	Depreciation - 2009 (3.33%) - Test Year		2,574	894	702	2,035	6,204
21	Accumulated Depreciation (Sum Lines 13 thru 20)²		\$ 16,206	\$ 3,614	\$ 1,053	\$ 3,050	\$ 23,923

¹ Depreciation rate changed from 2.5% to 3.33% May 1, 2007.

² \$23,923 adjustment to A/D is reflected in GLF-10, Line 2.

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Schedule GLF-6
Phase 2

ORIGINAL COST RATE BASE ADJUSTMENT # 2 - RECLASSIFY WATER TREATMENT EQUIPMENT

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	320	Water Treatment Equipment	\$ 15,947	\$ (15,947)	\$ -
2	320.1	Water Treatment Plant		-	-
3	320.2	Chemical Solution Feeders		\$ 15,947	\$ 15,947
4		Total	<u>\$ 15,947</u>	<u>\$ -</u>	<u>\$ 15,947</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony , SDR GTM-1.5

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-7
Phase 2

ORIGINAL COST RATE BASE ADJUSTMENT # 3 - RECLASSIFY DISTRIBUTION RESERVOIRS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	330	Distribution Reservoirs & Standpipe	\$ 836,890	\$ (836,890)	\$ -
2	330.1	Storage Tanks		\$ 384,827	\$ 384,827
3	330.2	Pressure Tanks		\$ 452,063	\$ 452,063
4		Total	<u>\$ 836,890</u>	<u>\$ -</u>	<u>\$ 836,890</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony, SDR GTM-1.4

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-8
Phase 2

ORIGINAL COST RATE BASE ADJUSTMENT # 4 - ELIMINATE EXCESS CAPACITY - STORAGE TANK

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	331	Storage Tanks ¹	\$ 384,827	\$ (72,350)	\$ 312,477

¹ The Company proposed amount is the portion claimed by the Company and reclassified by Staff to Acct. 330.1 as shown in GTM-7.

References:

Col [A]: Company Schedule B-1
Col [B]: GLF and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-9
Phase 2

ORIGINAL COST RATE BASE ADJUSTMENT # 5 - ELIMINATE EXCESS CAPACITY - DISTRIBUTION MAINS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	333	Transmission and Distribution Mains	<u>1,611,320</u>	<u>\$ (128,600)</u>	<u>\$ 1,482,720</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

ORIGINAL COST RATE BASE ADJUSTMENT # 6 - ADJUST ACCUMULATED DEPRECIATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Depreciation	\$ 731,205	\$ 16,013	\$ 747,218
			Accumulated Depreciation per application	Accumulated Depreciation per Staff	Difference
2		Structures and Improvements	\$ 10,285	\$ 34,208	\$ 23,923
3		Collecting and Impounding Res.	-	-	-
4		Lake River and other Intakes	-	-	-
5		Wells and Springs	67,423	67,423	0
6		Infiltration Galleries and Tunnels	-	-	-
7		Supply Mains	-	-	-
8		Power Generation Equipment	-	-	-
9		Electrical Pumping Equipment	341,101	341,101	0
10		Water Treatment Equipment	2,167	0	(2,167)
11		Water Treatment Plant	-	-	-
12		Chemical Solution Feeders	-	2,167	2,167
13		Distribution Reservoirs & Standpipe	64,318	-	(64,318)
14		Storage Tanks	-	27,712	27,712
15		Pressure Tanks	-	32,553	32,553
16		Transmission and Distribution Mains	139,059	135,201	(3,858)
17		Services	40,947	40,947	-
18		Meters	17,066	17,066	-
19		Hydrants	12,984	12,984	-
20		Backflow Prevention Devices	-	-	-
21		Other Plant & Miscellaneous Equipment	35,847	35,847	-
22		Office Furniture & Fixtures	-	-	-
23		Computers & Software	-	-	-
24		Transportation Equipment	-	-	-
25		Stores Equipment	-	-	-
26		Tools and Work Equipment	-	-	-
27		Laboratory Equipment	-	-	-
28		Power Operated Equipment	-	-	-
29		Communications Equipment	-	-	-
30		Miscellaneous Equipment	-	-	-
31		Other Tangible Plant	-	-	-
			\$ 731,197	\$ 747,210	\$ 16,013

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony, RUCO DR 2.12
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-10.1
Phase 2

ORIGINAL COST RATE BASE ADJUSTMENT # 7 - REDUCE AIAC

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	108	AIAC	<u>2,101,905</u>	<u>\$ (128,600)</u>	<u>\$ 1,973,305</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-10.2
Phase 2

ORIGINAL COST RATE BASE ADJUSTMENT # 8 - ACCUMULATED DEFERRED INCOME TAX

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Deferred Income Tax	<u>135,342</u>	<u>\$ (49,686)</u>	<u>\$ 85,656</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

ADIT Calculation

	Adj Book Value	Tax Value	Realization Probability	Expected Realized (Taxable TD) Deductible TD	Tax Rate	Future Tax Asset Current	Non-current	Future Tax Liability Current	Non-current
PIS	4,966,519								
A/D	(747,218)								
CIAC	(1,381,314)								
Total/ Fixed Assets	2,837,988	2,019,279	100%	(818,709)	37.8%				(309,316)
AIAC		1,973,305	30%	591,992	37.8%		223,660		
Totals						-	223,660	-	(309,316)
ADIT Net Asset (Liability) - Staff							(85,656)		
ADIT Net Asset (Liability) Company as Filed							(135,342)		
Staff Adjustment							49,686		

Computation of Net Tax Value at Dec. 31, 2009:

Unadjusted Cost per 2009 Tax Deprec Report	4,938,108	
Reconciling Items not on tax report		
Net Structures and Improvement to Land not on tax, used in rates	162,306	
Adjusted land costs not on tax, on books (Staff adjusted Land Value)	21,638	
Net Unadjusted Cost Tax Basis		5,122,053

Basis Reductions/Additions:

Basis reduction 2009 and prior years	(14,706)	
Advance or Contr plant with no deprec basis listed on 2009 Tax Deprec Report	(2,707,816)	
Accumulated Depreciation 2008 and prior (2009 Tax Deprec Report)	(339,352)	
Upsizing Adjustment - Tank	(72,350)	
Tax Depreciation related to Tank Upsizing	4,341	
Excess Capacity - Mains	128,600	
Tax Depreciation related to Excess Capacity - Mains (2008) (AIAC no depr)	-	
2009 Current Year Tax Depreciation	(101,491)	
Net Basis Reduction 2007 and Prior years		(3,102,774)
Net tax value of PIS at Dec. 31, 2008		2,019,279

CIAC (including impact of change to probability of realization)

Gross CIAC (Schedule B-2)	-	
Less: Pre-1996 CIAC	-	
A.A.	-	
A.A. on Pre-1996	-	
A.A. on Post 1996 CIAC	-	
Net CIAC before unrealized AIAC	-	

Unrealized AIAC Component:

Adjusted Net AIAC	1,973,305	
AIAC funding Mains	-	
Sub-total	1,973,305	
Unrealized AIAC Component % (1-Realized AIAC Component)	70%	
		1,381,314
Total Realizable CIAC		1,381,314

AIAC (including impact of change to probability of realization)

AIAC (Schedule B-2)	1,973,305	
Less: Pre-1996 AIAC included for book and tax purposes	-	
Net AIAC before unrealized portion		1,973,305
Less: Unrealized AIAC from above		(1,381,314)
Net Realizable AIAC		591,992

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

LINE NO.	DESCRIPTION	[A] COMPANY ADJUSTED TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
1	<u>OPERATING REVENUES:</u>					
2	Metered Water Revenues	\$ 559,013	\$ 21,708	\$ 580,721	\$ 103,500	\$ 684,221
3	Unmetered Water Revenues	-	-	-	-	-
4	Other Water Revenues	13,738	-	13,738	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ 594,459	\$ 103,500	\$ 697,959
6						
7	<u>OPERATING EXPENSES:</u>					
8	Salaries and Wages	\$ 40,000	\$ -	\$ 40,000	\$ -	\$ 40,000
9	Employee Pensions & Benefits	-	-	-	-	-
10	Purchased Water	-	-	-	-	-
11	Purchased Power	27,066	577	27,643	-	27,643
12	Chemicals	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	7,746	-	7,746
14	Office Supplies and Expense	14,855	-	14,855	-	14,855
15	Outside Services	102,925	-	102,925	-	102,925
16	Water Testing	1,215	1,568	2,783	-	2,783
17	Rents	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-
19	Insurance - General Liability	9,669	-	9,669	-	9,669
20	Insurance - Health and Life	-	-	-	-	-
21	Advertising	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	20,000	40,000	-	40,000
23	Regulatory Comm Expense - Other	378	-	378	-	378
24	Bad Debt Expense	-	-	-	-	-
25	Miscellaneous Expense	-	-	-	-	-
26	Depreciation and Amortization	227,855	17,249	245,104	-	245,104
27	Interest on Security Deposits	-	-	-	-	-
28	Taxes other than Income	2,988	-	2,988	-	2,988
29	Property Taxes	21,299	(2,250)	19,049	1,029	20,078
30	Income Tax	22,873	(12,813)	10,060	38,305	48,366
31	Total Operating Expenses	\$ 498,869	\$ 24,331	\$ 523,200	\$ 39,334	\$ 562,534
32						
33	Operating Income	\$ 73,882	\$ (2,623)	\$ 71,259	\$ 64,166	\$ 135,425

References:

- Column [A]: Company Schedule C-1
- Column [B]: Schedule GLF-12
- Column [C]: Column [A] + Column [B]
- Column [D]: Schedules GLF-1 and GLF-2
- Column [E]: Column [C] + Column [D]

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] GLF-13 Revenue Annualization ADJ #1	[C] GLF-14 Rate Case Exp ADJ #2	[D] GLF-15 Water Testing ADJ #3	[E] GLF-16 Depreciation Exp ADJ #4	[F] GLF-17 Property Taxes ADJ #5	[G] GLF-18 Income Taxes ADJ #6	[H] GLF-18.1 An Pur Pwr ADJ #7	[I] STAFF ADJUSTED
1	<u>Operating Revenues:</u>									
2	Metered Water Revenues	\$ 559,013	\$ 21,708		\$ -	\$ -	\$ -	\$ -	\$ -	\$ 580,721
3	Unmetered Water Revenues	-	-		-	-	-	-	-	-
4	Other Water Revenues	13,738	-		-	-	-	-	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 594,459
6										
7	<u>Operating Expenses:</u>									
8	Salaries and Wages	\$ 40,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	40,000
9	Employee Pensions & Benefits	-	-	-	-	-	-	-	-	-
10	Purchased Water	-	-	-	-	-	-	-	-	-
11	Purchased Power	27,066	-	-	-	-	-	-	577	27,643
12	Chemicals	-	-	-	-	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	-	-	-	-	-	-	7,746
14	Office Supplies and Expense	14,855	-	-	-	-	-	-	-	14,855
15	Outside Services	102,925	-	-	-	-	-	-	-	102,925
16	Water Testing	1,215	-	-	1,568	-	-	-	-	2,783
17	Rents	-	-	-	-	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-	-	-	-	-
19	Insurance - General Liability	9,669	-	-	-	-	-	-	-	9,669
20	Insurance - Health and Life	-	-	-	-	-	-	-	-	-
21	Advertising	-	-	-	-	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	-	20,000	-	-	-	-	-	40,000
23	Regulatory Comm Expense - Other	378	-	-	-	-	-	-	-	378
24	Bad Debt Expense	-	-	-	-	-	-	-	-	-
25	Miscellaneous Expense	227,855	-	-	-	17,249	-	-	-	245,104
26	Depreciation and Amortization	-	-	-	-	-	-	-	-	-
27	Interest on Security Deposits	2,988	-	-	-	-	-	-	-	2,988
28	Taxes other than Income	21,299	-	-	-	-	-	-	-	19,049
29	Property Taxes	22,873	-	-	-	-	(2,250)	-	-	10,060
30	Income Tax	498,869	-	\$ 20,000	\$ 1,568	\$ 17,249	\$ (2,250)	\$ (12,813)	\$ 577	\$ 523,200
31	Total Operating Expenses	\$ 73,882	\$ 21,708	\$ (20,000)	\$ (1,568)	\$ (17,249)	\$ 2,250	\$ 12,813	\$ (577)	\$ 71,259
	Operating Income									

References:
Column [A]: Company Schedule C-1
Column [B] - [G]: Schedule GTM-13 through GTM-17
Column [C]: Add Column [A] - Column [F]

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Schedule GLF-13
Phase 2

OPERATING INCOME ADJUSTMENT # 1 - REVENUE ANNUALIZATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Metered Water Revenues	<u>\$ 559,013</u>	<u>\$ 21,708</u>	<u>\$ 580,721</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-14
Phase 2

OPERATING INCOME ADJUSTMENT # 2 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Regulatory Commission Expense - Rate Case	\$ 20,000	\$ 20,000	\$ 40,000

References:

Column [A]: Company Schedule C-1

Column [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-15
Phase 2

OPERATING INCOME ADJUSTMENT # 3 - WATER TESTING EXPENSE

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Water Testing	\$ 1,215	\$ 1,568	\$ 2,783

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

OPERATING INCOME ADJUSTMENT # 4 - DEPRECIATION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Depreciation and Amortization	\$ 227,855	\$ 17,249	\$ 245,104

Line No.	ACCT NO.	DESCRIPTION	[A] Company Proposed PLANT IN SERVICE BALANCE	[B] STAFF DEPR. PLANT BALANCE	[C] STAFF RECOMMENDED RATE	[D] STAFF RECOMMENDED EXPENSE
Plant In Service						
2	301	Organization Cost	\$ 127,103	127,103	0.00%	\$ -
3	302	Franchise Cost	-	-	0.00%	-
4	303	Land and Land Rights	494,159	21,638	0.00%	-
5	304	Structures and Improvements	182,570	368,799	3.33%	12,281
6	305	Collecting and Impounding Res.	-	-	2.50%	-
7	306	Lake River and other Intakes	-	-	2.50%	-
8	307	Wells and Springs	386,591	386,591	3.33%	12,873
9	308	Infiltration Galleries and Tunnels	-	-	6.67%	-
10	309	Supply Mains	-	-	2.00%	-
11	310	Power Generation Equipment	-	-	5.00%	-
12	311	Electrical Pumping Equipment	968,652	968,652	12.50%	121,082
13	320.0	Water Treatment Equipment	15,947	-	-	-
14	320.1	Water Treatment Plant	-	-	3.33%	-
15	320.2	Chemical Solution Feeders	-	15,947	20.00%	3,189
16	330	Distribution Reservoirs & Standpipe	836,890	-	-	-
17	330	Storage Tanks	-	312,477	2.22%	6,937
18	330	Pressure Tanks	-	452,063	5.00%	22,603
19	331	Transmission and Distribution Mains	1,611,320	1,482,720	2.00%	29,654
20	333	Services	386,947	386,947	3.33%	12,885
21	334	Meters	94,263	94,263	8.33%	7,852
22	335	Hydrants	161,737	161,737	2.00%	3,235
23	336	Backflow Prevention Devices	-	-	6.67%	-
24	339	Other Plant & Miscellaneous Equipment	187,582	187,582	6.67%	12,512
25	340	Office Furniture & Fixtures	-	-	6.67%	-
26	340	Computers & Software	-	-	20.00%	-
27	341	Transportation Equipment	-	-	20.00%	-
28	342	Stores Equipment	-	-	4.00%	-
29	343	Tools and Work Equipment	-	-	5.00%	-
30	344	Laboratory Equipment	-	-	10.00%	-
31	345	Power Operated Equipment	-	-	5.00%	-
32	346	Communications Equipment	-	-	10.00%	-
33	347	Miscellaneous Equipment	-	-	10.00%	-
34	348	Other Tangible Plant	-	-	3.33%	-
35	-	Rounding Amount	-	-	67.00%	-
36		Subtotal General	\$ 5,453,761	\$ 4,966,519		\$ 245,104
37		Less: Non-depreciable Account(s)	621,262	148,741		
38		Depreciable Plant (L29-L30)	\$ 4,832,499	\$ 4,817,778		
39		Contributions-in-Aid-of-Construction (CIAC)			\$ -	
40		Weighted Average Depreciation/Amortization Rate			5.0875%	
41		Less: Amortization of CIAC (L32 x L33)				\$ -
42		Depreciation Expense - STAFF [Col. (C), L36 - L41]				\$ 245,104

OPERATING INCOME ADJUSTMENT # 5 - PROPERTY TAXES

LINE NO.	Property Tax Calculation	[A]	[B]
		STAFF AS ADJUSTED	STAFF RECOMMENDED
1	Staff Adjusted Test Year Revenues - 2009	\$ 594,459	\$ 594,459
2	Weight Factor	2	2
3	Subtotal (Line 1 * Line 2)	\$ 1,188,918	\$ 1,188,918
4a	Staff Adjusted Test Year Revenues - 2006	594,459	697,959
4b	Staff Recommended Revenue, Per Schedule GLF-1		697,959
5	Subtotal (Line 4 + Line 5)	\$ 1,783,377	\$ 1,886,877
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	\$ 594,459	\$ 628,959
8	Department of Revenue Multiplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	\$ 1,188,918	\$ 1,257,918
10	Plus: 10% of CWIP -		-
11	Less: Net Book Value of Licensed Vehicles		-
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$ 1,188,918	\$ 1,257,918
13	Assessment Ratio	20.0%	20.0%
14	Assessment Value (Line 12 * Line 13)	237,784	\$ 251,584
15	Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16)	7.4558%	7.4558%
16	Property Tax Expense - Excludes Parcels (Line 14 * Line 15)	\$ 17,729	\$ 18,758
17	Tax of Parcels	\$ 1,320	\$ 1,320
18	Staff Recommended Test Year Property Tax (Line 16 + Line 17)	\$ 19,049	
19	Company Proposed Property Tax	21,299	
20	Staff Test Year Adjustment (Line 18-Line 19)	\$ (2,250)	
21	Property Tax - Staff Recommended Revenue (Line 16 + Line 17)		\$ 20,078
22	Staff Test Year Adjusted Property Tax Expense (Line 18)		\$ 19,049
23	Increase/(Decrease) to Property Tax Expense Line 21 - Line 22)		\$ 1,029
24	Increase to Property Tax Expense		\$ 1,029
25	Increase in Revenue Requirement		103,500
26	Increase to Property Tax per Dollar Increase in Revenue (Line 24/Line 25)		0.994107%

References:

Col [A]: Company Schedule C-1 Page 3
Col [B]: GLF Testimony

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-18
Phase 2

OPERATING INCOME ADJUSTMENT # 6 - INCOME TAXES

LINE NO.	DESCRIPTION	[A] COMPANY	[B] STAFF	[C] STAFF
		PROPOSED	ADJUSTMENTS	RECOMMENDED
1	Income Tax	\$ 22,873	\$ (12,813)	\$ 10,060

References:

Col [A]: Company Schedule C-1 Page 3

Col [B]: Column [C] - Column [A]

Col [C]: Schedule GLF-2

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-18.1
Phase 2

OPERATING INCOME ADJUSTMENT # 7 - ANNUALIZE PURCHASED POWER

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Purchased Power	\$ 27,066	\$ 577	\$ 27,643

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

RATE DESIGN

Monthly Usage Charge	(all classes)	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" Meter - All Classes		\$ 42.20	\$ 56.97	\$ 45.00
3/4" Meter - All Classes		\$ 63.30	\$ 85.46	\$ 68.00
1" Meter - All Classes		\$ 105.50	\$ 142.43	\$ 113.00
1½" Meter - All Classes		\$ 211.50	\$ 284.85	\$ 225.00
2" Meter - All Classes		\$ 339.68	\$ 455.76	\$ 360.00
3" Meter - All Classes		\$ 675.20	\$ 911.52	\$ 720.00
4" Meter - All Classes		\$ 1,055.00	\$ 1,424.25	\$ 1,125.00
6" Meter - All Classes		\$ 2,110.00	\$ 2,848.50	\$ 2,250.00
Construction/Stand pipe		N/A	N/A	N/A
Commodity Rates (all classes)				
5/8" Meter				
From 1 to 3,000 Gallons		\$ 3.95	\$ 6.80	\$ 4.50
From 3,001 to 9,000 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 9,000 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
3/4" Meter				
From 1 to 3,000 Gallons		\$ 3.95	\$ 6.80	\$ 4.50
From 3,001 to 9,000 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 10,000 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
1" Meter				
From 1 to 22,500 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 22,500 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
1½" Meter				
From 1 to 34,000 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 34,000 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
2" Meter				
From 1 to 45,000 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 45,000 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
3" Meter				
From 1 to 68,000 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 68,000 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
4" Meter				
From 1 to 90,000 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 90,000 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
6" Meter (Res., Comm.)				
From 1 to 135,000 Gallons		\$ 5.91	\$ 10.92	\$ 9.10
Over 135,000 Gallons		\$ 7.11	\$ 13.13	\$ 11.00
Construction/Stand pipe (Res., Comm.)				
All Gallons		\$ 7.11	\$ 13.13	\$ 11.00

	Present	Co. Proposed			Staff Recommended		
Service Line and Meter Installation Charges	Total	Line	Meter	Total	Line	Meter	Total
5/8" Meter	\$ 225	\$ 385	\$ 135	\$ 520	\$ 385	\$ 135	\$ 520
3/4" Meter	270	415	205	620	415	205	620
1" Meter	300	465	265	730	465	265	730
1½" Meter	425	520	475	995	520	475	995
2" Turbine Meter	550	800	995	1,795	800	995	1,795
2" Compound Meter	550	800	1,840	2,640	800	1,840	2,640
3" Turbine Meter	750	1,015	1,620	2,635	1,015	1,620	2,635
3" Compound Meter	750	1,135	2,495	3,630	1,135	2,495	3,630
4" Turbine Meter	1,375	1,430	2,570	4,000	1,430	2,570	4,000
4" Compound Meter	1,375	1,610	3,545	5,155	1,610	3,545	5,155
6" Turbine Meter	2,800	2,150	4,925	7,075	2,150	4,925	7,075
6" Compound Meter	2,800	2,270	6,820	9,090	2,270	6,820	9,090
8"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
10"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
12"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
Service Charges							
Establishment	\$ 50.00	\$ 50.00			\$ 50.00		
Establishment (After Hours)	75.00	75.00			NT		
Reconnection (delinquent)	75.00	75.00			75.00		
Reconnection (after hours)	50.00	50.00			NT		
Meter Test	20.00	20.00			20.00		
Deposit Requirement (Residential)	(a)	(a)			(a)		
Deposit Requirement (None Residential Meter)	(a)	(a)			(a)		
Deposit Interest	6.00%	6.00%			6.00%		
Re-Establishment (With-in 12 Months)	(b)	(b)			(b)		
NSF Check	15.00	15.00			15.00		
Deferred Payment, Per Month	1.5%	1.50%			1.50%		
Meter Re-Read	20.00	20.00			20.00		
Late Charge per month	1.5%	1.5%			1.5%		
Customer Requested Meter Test	20.00	20.00			20.00		
After Hours Service Charge	10.00	10.00			50.00		
Turn-on/off (at customer request)	NT	75.00			NT		
Moving Customer Meter (at customer request)	NT	cost			cost		
NT = No Tariff							
Monthly Service Charge for Fire Sprinkler							
All Meter Sizes					Greater of \$10 or 2 percent of the general service rate for a similar size meter.		

Per Commission Rules (R14-2-403.B)

- (a) Residential - two times the average bill. Non-residential - two and one-half times the average bill.
- (b) Minimum charge times number of months disconnected.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission Rule (14-2-409.D.5).

All advances and/or contributions are to include labor, materials, overheads and all applicable taxes, Cost to include labor, materials and parts, overheads and all applicable taxes.

Typical Bill Analysis
Residential 5/8 Inch Meter

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	5,477	\$ 66.73	\$ 100.30	\$ 33.57	50.31%
Median Usage	4,500	60.96	89.63	\$ 28.68	47.04%

Staff Recommended

Average Usage	5,477	\$ 66.73	\$ 81.04	\$ 14.31	21.45%
Median Usage	4,500	60.96	72.15	\$ 11.20	18.37%

Present & Proposed Rates (Without Taxes)
Residential 5/8 Inch Meter

Consumption	Rates	Rates	Increase	Rates	Increase
-	\$ 42.20	\$ 56.97	35.00%	\$ 45.00	6.64%
1,000	46.15	63.77	38.18%	49.50	7.26%
2,000	50.10	70.57	40.86%	54.00	7.78%
3,000	54.05	77.37	43.15%	58.50	8.23%
4,000	58.00	84.17	45.12%	67.60	16.55%
4,500	60.96	89.63	47.04%	72.15	18.37%
5,000	63.91	95.09	48.79%	76.70	20.01%
5,477	66.73	100.30	50.31%	81.04	21.45%
6,000	69.82	106.01	51.83%	85.80	22.89%
7,000	75.73	116.93	54.40%	94.90	25.31%
8,000	81.64	127.85	56.60%	104.00	27.39%
9,000	87.55	138.77	58.50%	113.10	29.18%
10,000	94.66	151.90	60.47%	124.10	31.10%
11,000	101.77	165.03	62.16%	135.10	32.75%
12,000	108.88	178.16	63.63%	146.10	34.18%
13,000	115.99	191.29	64.92%	157.10	35.44%
14,000	123.10	204.42	66.06%	168.10	36.56%
15,000	130.21	217.55	67.08%	179.10	37.55%
16,000	137.32	230.68	67.99%	190.10	38.44%
17,000	144.43	243.81	68.81%	201.10	39.24%
18,000	151.54	256.94	69.55%	212.10	39.96%
19,000	158.65	270.07	70.23%	223.10	40.62%
20,000	165.76	283.20	70.85%	234.10	41.23%
25,000	201.31	348.85	73.29%	289.10	43.61%
30,000	236.86	414.50	75.00%	344.10	45.28%
35,000	272.41	480.15	76.26%	399.10	46.51%
40,000	307.96	545.80	77.23%	454.10	47.45%
45,000	343.51	611.45	78.00%	509.10	48.21%
50,000	379.06	677.10	78.63%	564.10	48.82%
75,000	556.81	1,005.35	80.56%	839.10	50.70%
100,000	734.56	1,333.60	81.55%	1,114.10	51.67%

TESTIMONY - GORDON L. FOX

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GLF-2	GROSS REVENUE CONVERSION FACTOR
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GLF-5	ORIGINAL COST RATE BASE ADJUSTMENT # 1 - REDUCE COST BASIS FOR LAND PURCHASE
GLF-6	ORIGINAL COST RATE BASE ADJUSTMENT # 2 - RECLASSIFY WATER TREATMENT EQUIPMENT
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GLF-13	OPERATING INCOME ADJUSTMENT # 1 - REVENUE ANNUALIZATION
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GLF-18.1	OPERATING INCOME ADJUSTMENT # 7 - ANNUALIZE PURCHASED POWER
GLF-19	RATE DESIGN
GLF-20	TYPICAL BILL ANALYSIS

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY FAIR VALUE	(C) STAFF ORIGINAL COST	(D) STAFF FAIR VALUE
1	Adjusted Rate Base	\$ 2,402,222	\$ 2,402,222	\$ 2,077,253	\$ 2,077,253
2	Adjusted Operating Income (Loss)	\$ 73,882	\$ 73,882	\$ 71,259	\$ 71,259
3	Current Rate of Return (L2 / L1)	3.08%	3.08%	3.43%	3.43%
4	Required Rate of Return	10.54%	10.54%	7.45%	7.45%
5	Required Operating Income (L4 * L1)	\$ 253,194	\$ 253,194	\$ 154,809	\$ 154,809
6	Operating Income Deficiency (L5 - L2)	\$ 179,312	\$ 179,312	\$ 83,550	\$ 83,550
7	Gross Revenue Conversion Factor	1.6254	1.6254	1.6517	1.6517
8	Required Revenue Increase (L7 * L6)	\$ 291,454	\$ 291,454	\$ 138,000	\$ 138,000
9	Adjusted Test Year Revenue	\$ 572,751	\$ 572,751	\$ 594,459	\$ 594,459
10	Proposed Annual Revenue (L8 + L9)	\$ 864,205	\$ 864,205	\$ 732,459	\$ 732,459
11	Required Increase in Revenue (%)	50.89%	50.89%	23.21%	23.21%
12	Rate of Return on Common Equity (%)	11.00%	11.00%		

References:

Column (A): Company Schedule B-1
Column (B): Company Schedule B-1
Column (C): Company Schedules A-1, A-2, & D-1
Column (D): Staff Schedule GLF-2 , GLF-3 & GLF-11

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<u>Calculation of Gross Revenue Conversion Factor:</u>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.0000%			
3	Revenues (L1 - L2)	100.0000%			
4	Combined Federal and State Tax Rate (Line 17) + Property Tax Factor (Line 23)	39.4566%			
5	Subtotal (L3 - L4)	60.5434%			
6	Revenue Conversion Factor (L1 / L5)	1.6517			
<u>Calculation of Uncollectible Factor:</u>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	38.8487%			
9	One Minus Combined Income Tax Rate (L7 - L8)	61.1513%			
10	Uncollectible Rate	0.0000%			
11	Uncollectible Factor (L9 * L10)	0			
<u>Calculation of Effective Tax Rate:</u>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	6.9680%			
14	Federal Taxable Income (L12 - L13)	93.0320%			
15	Applicable Federal Income Tax Rate (Line 53)	34.2685%			
16	Effective Federal Income Tax Rate (L14 x L15)	0.318806934			
17	Combined Federal and State Income Tax Rate (L13 + L16)	38.8487%			
<u>Calculation of Effective Property Tax Factor</u>					
18	Unity	100.0000%			
19	Combined Federal and State Tax Rate (Line 17)	38.8487%			
20	One Minus Combined Income Tax Rate (L18 - L19)	61.1513%			
21	Property Tax Factor (GLF-17, L26)	0.9941%			
22	Effective Property Tax Factor (L 21 * L 22)	0.6079%			
23	Combined Federal and State Tax and Property Tax Rate (L17+L22)		39.4566%		
24	Required Operating Income (Schedule GLF-1, Line 5)	\$ 154,809			
25	Adjusted Test Year Operating Income (Loss) (Schedule GLF-11, Line 33)	\$ 71,259			
26	Required Increase in Operating Income (L24 - L25)		\$ 83,550		
27	Income Taxes on Recommended Revenue (Col. (D), L52)	\$ 63,139			
28	Income Taxes on Test Year Revenue (Col. (B), L52)	\$ 10,060			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		\$ 53,078		
30	Recommended Revenue Requirement (Schedule GLF-1, Line 10)	\$ 732,459			
31	Uncollectible Rate (Line 10)	0.0000%			
32	Uncollectible Expense on Recommended Revenue (L24 * L25)	\$ -			
33	Adjusted Test Year Uncollectible Expense	\$ -			
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32 - L33)		\$ -		
35	Property Tax with Recommended Revenue (GLF-17, L21)	\$ 20,421			
36	Property Tax on Test Year Revenue (GLF-17, L22)	\$ 19,049			
37	Increase in Property Tax Due to Increase in Revenue (GLF-17, L23)		\$ 1,372		
38	Total Required Increase in Revenue (L26 + L29 + L34+L37)		\$ 138,000		
<u>Calculation of Income Tax:</u>					
39	Revenue (Schedule GLF-11, Col.(C), Line 5 & Sch. GLF-1, Col. (D), Line 10)	\$ 594,459		STAFF Recommended	
40	Operating Expenses Excluding Income Taxes	\$ 513,139		\$ 732,459	
41	Synchronized Interest (L56)	\$ 33,236		\$ 514,511	
42	Arizona Taxable Income (L39 - L40- L41)	\$ 48,083		\$ 33,236	
43	Arizona State Income Tax Rate	6.9680%		\$ 184,712	
44	Arizona Income Tax (L42 x L43)		\$ 3,350	6.9680%	
45	Federal Taxable Income (L42 - L44)	\$ 44,733		\$ 171,841	\$ 12,871
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ 6,710		\$ 7,500	
47	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	\$ -		\$ 6,250	
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -		\$ 8,500	
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -		\$ 28,018	
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -		\$ -	
51	Total Federal Income Tax	\$ 6,710		\$ 50,268	
52	Combined Federal and State Income Tax (L44 + L51)	\$ 10,060		\$ 63,139	
53	Applicable Federal Income Tax Rate [Col. (D), L51 - Col. (B), L51] / [Col. (C), L44 - Col. (A), L44]				34.27%
<u>Calculation of Interest Synchronization:</u>					
54	Rate Base (Schedule GLF-3, Col. (C), Line (14))	\$ 2,077,253			
55	Weighted Average Cost of Debt (Surrebuttal Schedule JCM-1)	1.60%			
56	Synchronized Interest (L54 X L55)	\$ 33,236			

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-3
Phase 3

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	REF	(C) STAFF AS ADJUSTED
1	Plant in Service	\$ 5,453,761	\$ (487,242)	\$ 4,966,519
2	Less: Accumulated Depreciation	731,205	16,013	747,218
3	Net Plant in Service	<u>\$ 4,722,556</u>	<u>\$ (503,255)</u>	<u>\$ 4,219,301</u>
<u>LESS:</u>				
4	Contributions in Aid of Construction (CIAC)	\$ -	\$ -	\$ -
5	Less: Accumulated Amortization	-	-	-
6	Net CIAC	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
7	Advances in Aid of Construction (AIAC)	2,101,905	(128,600)	1,973,305
8	Service Line & Meter Installation Charges	83,087	-	83,087
9	Deferred Income Tax Credits	135,342	(49,686)	85,656
<u>ADD:</u>				
10	Unamortized Finance Charges	-	-	-
11	Deferred Tax Assets	-	-	-
12	Working Capital	-	-	-
13	Intentionally Left Blank	-	-	-
14	Original Cost Rate Base	<u>\$ 2,402,222</u>	<u>\$ (324,969)</u>	<u>\$ 2,077,253</u>

References:

Column (A), Company Schedule B-1
Column [B]: Column [C] - Column [A]
Column [C], GLF-4

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	ACCT. NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) LAND ADJ.#1	(C) WATER TREATMENT ADJ.#2	(D) DISTRIBUTION RESERVOIR ADJ.#3	(E) DISTRIBUTION RESERVOIR ADJ.#4	(F) TRANSMISSION MAINS ADJ.#5	(G) TRANSMISSION DEPRECIATION ADJ.#6	(C) AIAC ADJ.#7	(I) ADIT ADJ.#8	(J) STAFF ADJUSTED
PLANT IN SERVICE:												
1	301	Organization Cost	\$ 127,103	-	-	-	-	-	-	-	-	\$ 127,103
2	302	Franchise Cost	-	-	-	-	-	-	-	-	-	-
3	303	Land and Land Rights	494,159	(472,521)	-	-	-	-	-	-	-	21,638
4	304	Structures and Improvements	182,570	186,229	-	-	-	-	-	-	-	368,799
5	305	Collecting and Impounding Res.	-	-	-	-	-	-	-	-	-	-
6	306	Lake River and other Intakes	-	-	-	-	-	-	-	-	-	-
7	307	Wells and Springs	386,591	-	-	-	-	-	-	-	-	386,591
8	308	Infiltration Galleries and Tunnels	-	-	-	-	-	-	-	-	-	-
9	309	Supply Mains	-	-	-	-	-	-	-	-	-	-
10	310	Power Generation Equipment	-	-	-	-	-	-	-	-	-	-
11	311	Electrical Pumping Equipment	968,652	-	(15,947)	-	-	-	-	-	-	968,652
12	320	Water Treatment Plant	15,947	-	-	-	-	-	-	-	-	-
13	320.1	Water Treatment Plant	-	-	-	-	-	-	-	-	-	-
14	320.2	Chemical Solution Feeders	-	-	-	-	(72,350)	-	-	-	-	15,947
15	330	Distribution Reservoirs & Standpipe	836,890	-	-	(836,890)	-	-	-	-	-	312,477
16	330.1	Storage Tanks	-	-	-	384,827	-	-	-	-	-	452,063
17	330.2	Pressure Tanks	-	-	-	452,063	-	-	-	-	-	1,482,720
18	331	Transmission and Distribution Mains	1,611,320	-	-	-	-	-	-	-	-	386,947
19	333	Services	386,947	-	-	-	-	(128,600)	-	-	-	94,263
20	334	Meters	94,263	-	-	-	-	-	-	-	-	161,737
21	335	Hydrants	161,737	-	-	-	-	-	-	-	-	-
22	336	Backflow Prevention Devices	-	-	-	-	-	-	-	-	-	187,582
23	339	Other Plant & Miscellaneous Equipment	187,582	-	-	-	-	-	-	-	-	-
24	340	Office Furniture & Fixtures	-	-	-	-	-	-	-	-	-	-
25	340.1	Computers & Software	-	-	-	-	-	-	-	-	-	-
26	341	Transportation Equipment	-	-	-	-	-	-	-	-	-	-
27	342	Stores Equipment	-	-	-	-	-	-	-	-	-	-
28	343	Tools and Work Equipment	-	-	-	-	-	-	-	-	-	-
29	344	Laboratory Equipment	-	-	-	-	-	-	-	-	-	-
30	345	Power Operated Equipment	-	-	-	-	-	-	-	-	-	-
31	346	Communications Equipment	-	-	-	-	-	-	-	-	-	-
32	347	Miscellaneous Equipment	-	-	-	-	-	-	-	-	-	-
33	348	Other Tangible Plant	-	-	-	-	-	-	-	-	-	-
34		Rounding Amount	\$ 5,453,761	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ -	\$ -	\$ -	\$ 4,966,519
35		Subtotal Plant in Service										
36		Intentionally Left Blank										
37		Intentionally Left Blank										
38		Intentionally Left Blank										
39		Intentionally Left Blank										
40		Intentionally Left Blank										
41		Intentionally Left Blank										
42		Intentionally Left Blank										
43		Total Plant in Service:	\$ 5,453,761	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ 16,013	\$ -	\$ -	\$ 4,966,519
44		Less: Accumulated Depreciation	731,205	-	-	-	-	-	-	-	-	\$ 747,218
45		Intentionally Left Blank										
46		Net Plant in Service (L59 - L 60)	\$ 4,722,556	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ (16,013)	\$ -	\$ -	\$ 4,219,301
47		Intentionally Left Blank										
48		Intentionally Left Blank										
49		Intentionally Left Blank										
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59		Intentionally Left Blank										
60		Intentionally Left Blank										
61		Intentionally Left Blank										
LESS:												
48		Contributions in Aid of Construction (CIAC)										
49		Less: Accumulated Amortization										
50		Net CIAC (L49 - L50)										
51		Advances in Aid of Construction (AIAC)	2,101,905	-	-	-	-	-	-	(128,600)	-	1,973,305
52		Service Line & Meter Installation Charges	83,087	-	-	-	-	-	-	-	-	83,087
53		Deferred Income Tax Credit	135,342	-	-	-	-	-	-	-	(49,886)	85,656
54		Intentionally Left Blank										
55		Intentionally Left Blank										
56		Intentionally Left Blank										
57		Intentionally Left Blank										
58		Intentionally Left Blank										
59		Intentionally Left Blank										
60		Intentionally Left Blank										
61		Intentionally Left Blank										
ADD:												
56		Unamortized Finance Charges										
57		Deferred Tax Assets										
58		Working Capital										
59		Regulatory Asset (Liability)										
60		Original Cost Rate Base	\$ 2,402,222	\$ (286,292)	\$ -	\$ -	\$ (72,350)	\$ (128,600)	\$ (16,013)	\$ 128,600	\$ 49,886	\$ 2,077,253

References:
Column [A] Schedule B-2, E-1

ORIGINAL COST RATE BASE ADJUSTMENT # 1 - LAND PURCHASE

LINE NO.	Description	Account Number	COMPANY PROPOSED	STAFF ADJUSTMENTS	STAFF RECOMMENDED		
1	Land and Land Rights	303	\$ 494,159	\$ (472,521)	\$ 21,638		
2	Structures & Improvements	304	\$ 182,570	\$ 186,229	\$ 368,799		
			Plant 1 0.72 Acres	Plant 2 0.25 Acres	Plant 4 0.39 Acres	Plant 3 0.63 Acres	Total 1.99 Acres
Land:							
3	Purchase Price (467.155 Acres)	\$ 4,103,318	\$ 6,324	\$ 2,196	\$ 3,426	\$ 5,534	\$ 17,479
4	Closing Costs						\$ 2,159
5	Appraisal Fee						\$ 2,000
6	Total Land						\$ 21,638
Structures and Improvements:							
7	GRA Improvements 4/15/85 to 6/12/01	\$ 795,363	\$ 1,226	\$ 426	\$ 664	\$ 1,073	\$ 3,388
8	Phase I Development Costs (68.93 Acres)	\$ 7,283,576	76,080	26,417	-	-	\$ 102,496
9	Phase III Development Costs (43.66 Acres)	\$ 2,284,877	-	-	20,410	-	\$ 20,410
10	Phase IV Development Costs (95.705 Acres)	\$ 9,104,785	-	-	-	59,934	\$ 59,934
11	Total Add'l Structures and Improvements		\$ 77,306	\$ 26,842	\$ 21,074	\$ 61,007	\$ 186,229
Accumulated Depreciation - Structures and Improvements - Book:							
In Service Date:			5/1/02	8/1/05	1/1/08	10/1/08	
12	Depreciation Basis (Line 11)		\$ 77,306	\$ 26,842	\$ 21,074	\$ 61,007	\$ 186,229
13	Depreciation - 2002 (2.5%)		966				966
14	Depreciation - 2003 (2.5%)		1,933				1,933
15	Depreciation - 2004 (2.5%)		1,933				1,933
16	Depreciation - 2005 (2.5%)		1,933	336			2,268
17	Depreciation - 2006 (2.5%)		1,933	671			2,604
18	Depreciation - 2007 (2.5%*4/12) +(3.33%*8/12) ¹		2,360	820			3,180
19	Depreciation - 2008 (3.33%)		2,574	894	351	1,016	4,835
20	Depreciation - 2009 (3.33%) - Test Year		2,574	894	702	2,035	6,204
21	Accumulated Depreciation (Sum Lines 13 thru 20) ²		\$ 16,206	\$ 3,614	\$ 1,053	\$ 3,050	\$ 23,923

¹ Depreciation rate changed from 2.5% to 3.33% May 1, 2007.

² \$23,923 adjustment to A/D is reflected in GLF-10, Line 2.

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Schedule GLF-6
Phase 3

ORIGINAL COST RATE BASE ADJUSTMENT # 2 - RECLASSIFY WATER TREATMENT EQUIPMENT

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	320	Water Treatment Equipment	\$ 15,947	\$ (15,947)	\$ -
2	320.1	Water Treatment Plant		-	-
3	320.2	Chemical Solution Feeders		\$ 15,947	\$ 15,947
4		Total	<u>\$ 15,947</u>	<u>\$ -</u>	<u>\$ 15,947</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony , SDR GTM-1.5

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-7
Phase 3

ORIGINAL COST RATE BASE ADJUSTMENT # 3 - RECLASSIFY DISTRIBUTION RESERVOIRS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	330	Distribution Reservoirs & Standpipe	\$ 836,890	\$ (836,890)	\$ -
2	330.1	Storage Tanks		\$ 384,827	\$ 384,827
3	330.2	Pressure Tanks		\$ 452,063	\$ 452,063
4		Total	<u>\$ 836,890</u>	<u>\$ -</u>	<u>\$ 836,890</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony, SDR GTM-1.4

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-8
Phase 3

ORIGINAL COST RATE BASE ADJUSTMENT # 4 - ELIMINATE EXCESS CAPACITY - STORAGE TANK

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	331	Storage Tanks ¹	<u>\$ 384,827</u>	<u>\$ (72,350)</u>	<u>\$ 312,477</u>

¹ The Company proposed amount is the portion claimed by the Company and reclassified by Staff to Acct. 330.1 as shown in GTM-7.

References:

Col [A]: Company Schedule B-1
Col [B]: GLF and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-9
Phase 3

ORIGINAL COST RATE BASE ADJUSTMENT # 5 - ELIMINATE EXCESS CAPACITY - DISTRIBUTION MAINS

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	333	Transmission and Distribution Mains	<u>1,611,320</u>	<u>\$ (128,600)</u>	<u>\$ 1,482,720</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GTM and MSJ Testimony
Col [C]: Col. [A] + Col. [B]

ORIGINAL COST RATE BASE ADJUSTMENT # 6 - ADJUST ACCUMULATED DEPRECIATION

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Depreciation	\$ 731,205	\$ 16,013	\$ 747,218
			Accumulated Depreciation per application	Accumulated Depreciation per Staff	Difference
2		Structures and Improvements	\$ 10,285	\$ 34,208	\$ 23,923
3		Collecting and Impounding Res.	-	-	-
4		Lake River and other Intakes	-	-	-
5		Wells and Springs	67,423	67,423	0
6		Infiltration Galleries and Tunnels	-	-	-
7		Supply Mains	-	-	-
8		Power Generation Equipment	-	-	-
9		Electrical Pumping Equipment	341,101	341,101	0
10		Water Treatment Equipment	2,167	0	(2,167)
11		Water Treatment Plant	-	-	-
12		Chemical Solution Feeders	-	2,167	2,167
13		Distribution Reservoirs & Standpipe	64,318	-	(64,318)
14		Storage Tanks	-	27,712	27,712
15		Pressure Tanks	-	32,553	32,553
16		Transmission and Distribution Mains	139,059	135,201	(3,858)
17		Services	40,947	40,947	-
18		Meters	17,066	17,066	-
19		Hydrants	12,984	12,984	-
20		Backflow Prevention Devices	-	-	-
21		Other Plant & Miscellaneous Equipment	35,847	35,847	-
22		Office Furniture & Fixtures	-	-	-
23		Computers & Software	-	-	-
24		Transportation Equipment	-	-	-
25		Stores Equipment	-	-	-
26		Tools and Work Equipment	-	-	-
27		Laboratory Equipment	-	-	-
28		Power Operated Equipment	-	-	-
29		Communications Equipment	-	-	-
30		Miscellaneous Equipment	-	-	-
31		Other Tangible Plant	-	-	-
			\$ 731,197	\$ 747,210	\$ 16,013

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony, RUCO DR 2.12
Col [C]: Col. [A] + Col. [B]

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Schedule GLF-10.1
Phase 3

ORIGINAL COST RATE BASE ADJUSTMENT # 7 - REDUCE AIAC

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	108	AIAC	<u>2,101,905</u>	<u>\$ (128,600)</u>	<u>\$ 1,973,305</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-10.2
Phase 3

ORIGINAL COST RATE BASE ADJUSTMENT # 8 - ACCUMULATED DEFERRED INCOME TAX

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Accumulated Deferred Income Tax	135,342	\$ (49,686)	\$ 85,656

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

ADIT Calculation

	Adj Book Value	Tax Value	Realization Probability	Expected Realized (Taxable TD) Deductible TD	Tax Rate	Future Tax Asset Current	Non-current	Future Tax Liability Current	Non-current
PIS	4,966,519								
AVD	(747,218)								
CIAC	(1,381,314)								
Total/ Fixed Assets	2,837,988	2,019,279	100%	(818,709)	37.8%				(309,316)
AIAC		1,973,305	30%	591,992	37.8%		223,660		
Totals						-	223,660	-	(309,316)

ADIT Net Asset (Liability) - Staff	(85,656)
ADIT Net Asset (Liability) Company as Filed	(135,342)
Staff Adjustment	48,686

Computation of Net Tax Value at Dec. 31, 2009:

Unadjusted Cost per 2009 Tax Deprec Report	4,938,108
Reconciling Items not on tax report	
Net Structures and Improvement to Land not on tax, used in rates	162,306
Adjusted land costs not on tax, on books (Staff adjusted Land Value)	21,638
Net Unadjusted Cost Tax Basis	5,122,053

Basis Reductions/Additions:

Basis reduction 2009 and prior years	(14,706)
Advance or Contr plant with no deprec basis listed on 2009 Tax Deprec Report	(2,707,816)
Accumulated Depreciation 2008 and prior (2009 Tax Deprec Report)	(339,352)
Upsizing Adjustment - Tank	(72,350)
Tax Depreciation related to Tank Upsizing	4,341
Excess Capacity - Mains	128,600
Tax Depreciation related to Excess Capacity - Mains (2008) (AIAC no depr)	-
2009 Current Year Tax Depreciation	(101,491)
Net Basis Reduction 2007 and Prior years	(3,102,774)
Net tax value of PIS at Dec. 31, 2008	2,019,279

CIAC (including impact of change to probability of realization)

Gross CIAC (Schedule B-2)	-
Less: Pre-1996 CIAC	-
A.A.	-
A.A. on Pre-1996	-
A.A. on Post 1996 CIAC	-
Net CIAC before unrealized AIAC	-

Unrealized AIAC Component:

Adjusted Net AIAC	1,973,305
AIAC funding Mains	-
Sub-total	1,973,305
Unrealized AIAC Component % (1-Realized AIAC Component)	70%
	1,381,314
Total Realizable CIAC	1,381,314

AIAC (including impact of change to probability of realization)

AIAC (Schedule B-2)	1,973,305
Less: Pre-1996 AIAC included for book and tax purposes	-
Net AIAC before unrealized portion	1,973,305
Less: Unrealized AIAC from above	(1,381,314)
Net Realizable AIAC	591,992

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

LINE NO.	DESCRIPTION	[A] COMPANY ADJUSTED TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
1	<u>OPERATING REVENUES:</u>					
2	Metered Water Revenues	\$ 559,013	\$ 21,708	\$ 580,721	\$ 138,000	\$ 718,721
3	Unmetered Water Revenues	-	-	-	-	-
4	Other Water Revenues	13,738	-	13,738	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ 594,459	\$ 138,000	\$ 732,459
6						
7	<u>OPERATING EXPENSES:</u>					
8	Salaries and Wages	\$ 40,000	-	\$ 40,000	-	\$ 40,000
9	Employee Pensions & Benefits	-	-	-	-	-
10	Purchased Water	-	-	-	-	-
11	Purchased Power	27,066	577	27,643	-	27,643
12	Chemicals	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	7,746	-	7,746
14	Office Supplies and Expense	14,855	-	14,855	-	14,855
15	Outside Services	102,925	-	102,925	-	102,925
16	Water Testing	1,215	1,568	2,783	-	2,783
17	Rents	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-
19	Insurance - General Liability	9,669	-	9,669	-	9,669
20	Insurance - Health and Life	-	-	-	-	-
21	Advertising	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	20,000	40,000	-	40,000
23	Regulatory Comm Expense - Other	378	-	378	-	378
24	Bad Debt Expense	-	-	-	-	-
25	Miscellaneous Expense	-	-	-	-	-
26	Depreciation and Amortization	227,855	17,249	245,104	-	245,104
27	Interest on Security Deposits	-	-	-	-	-
28	Taxes other than Income	2,988	-	2,988	-	2,988
29	Property Taxes	21,299	(2,250)	19,049	1,372	20,421
30	Income Tax	22,873	(12,813)	10,060	53,078	63,139
31	Total Operating Expenses	\$ 498,869	\$ 24,331	\$ 523,200	\$ 54,450	\$ 577,650
32						
33	Operating Income	\$ 73,882	\$ (2,623)	\$ 71,259	\$ 83,550	\$ 154,809

References:

Column [A]: Company Schedule C-1
Column [B]: Schedule GLF-12
Column [C]: Column [A] + Column [B]
Column [D]: Schedules GLF-1 and GLF-2
Column [E]: Column [C] + Column [D]

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SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] GLF-13 Revenue Annualization ADJ #1	[C] GLF-14 Rate Case Exp ADJ #2	[D] GLF-15 Water Testing ADJ #3	[E] GLF-16 Depreciation Exp ADJ #4	[F] GLF-17 Property Taxes ADJ #5	[G] GLF-18 Income Taxes ADJ #6	[H] GLF-18.1 An Pur Pwr ADJ #7	[I] STAFF ADJUSTED
1	<u>Operating Revenues:</u>									
2	Metered Water Revenues	\$ 559,013	\$ 21,708		\$ -	\$ -	\$ -	\$ -	\$ -	\$ 580,721
3	Unmetered Water Revenues	-	-		-	-	-	-	-	-
4	Other Water Revenues	13,738	-		-	-	-	-	-	13,738
5	Total Operating Revenues	\$ 572,751	\$ 21,708	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 594,459
6										
7	<u>Operating Expenses:</u>									
8	Salaries and Wages	\$ 40,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	40,000
9	Employee Pensions & Benefits	-	-	-	-	-	-	-	-	-
10	Purchased Water	-	-	-	-	-	-	-	-	-
11	Purchased Power	27,066	-	-	-	-	-	-	577	27,643
12	Chemicals	-	-	-	-	-	-	-	-	-
13	Repairs and Maintenance	7,746	-	-	-	-	-	-	-	7,746
14	Office Supplies and Expense	14,855	-	-	-	-	-	-	-	14,855
15	Outside Services	102,925	-	-	-	-	-	-	-	102,925
16	Water Testing	1,215	-	-	1,568	-	-	-	-	2,783
17	Rentals	-	-	-	-	-	-	-	-	-
18	Transportation Expenses	-	-	-	-	-	-	-	-	-
19	Insurance - General Liability	9,669	-	-	-	-	-	-	-	9,669
20	Insurance - Health and Life	-	-	-	-	-	-	-	-	-
21	Advertising	-	-	-	-	-	-	-	-	-
22	Regulatory Comm Expense - Rate Case	20,000	-	20,000	-	-	-	-	-	40,000
23	Regulatory Comm Expense - Other	378	-	-	-	-	-	-	-	378
24	Bad Debt Expense	-	-	-	-	-	-	-	-	-
25	Miscellaneous Expense	227,855	-	-	-	-	-	-	-	245,104
26	Depreciation and Amortization	-	-	-	-	17,249	-	-	-	-
27	Interest on Security Deposits	-	-	-	-	-	-	-	-	-
28	Taxes other than Income	2,988	-	-	-	-	-	-	-	2,988
29	Property Taxes	21,299	-	-	-	-	(2,250)	-	-	19,049
30	Income Tax	22,873	-	-	-	-	-	(12,813)	-	10,060
31	Total Operating Expenses	\$ 498,869	\$ -	\$ 20,000	\$ 1,568	\$ 17,249	\$ (2,250)	\$ (12,813)	\$ 577	\$ 523,200
	Operating Income	\$ 73,882	\$ 21,708	\$ (20,000)	\$ (1,568)	\$ (17,249)	\$ 2,250	\$ 12,813	\$ (577)	\$ 71,259

References:
Column [A]: Company Schedule C-1
Column [B] - [G]: Schedule GTM-13 through GTM-17
Column [C]: Add Column [A] - Column [F]

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Schedule GLF-13
Phase 3

OPERATING INCOME ADJUSTMENT # 1 - REVENUE ANNUALIZATION

<u>LINE NO.</u>	<u>Account Number</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1		Metered Water Revenues	<u>\$ 559,013</u>	<u>\$ 21,708</u>	<u>\$ 580,721</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-14
Phase 3

OPERATING INCOME ADJUSTMENT # 2 - RATE CASE EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY <u>PROPOSED</u>	[B] STAFF <u>ADJUSTMENTS</u>	[C] STAFF <u>RECOMMENDED</u>
		<u>\$ 20,000</u>	<u>\$ 20,000</u>	<u>\$ 40,000</u>
1	Regulatory Commission Expense - Rate Case			

References:

Column [A]: Company Schedule C-1

Column [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

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Schedule GLF-15
Phase 3

OPERATING INCOME ADJUSTMENT # 3 - WATER TESTING EXPENSE

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Water Testing	<u>\$ 1,215</u>	<u>\$ 1,568</u>	<u>\$ 2,783</u>

References:

Col [A]: Company Schedule B-1
Col [B]: GLF Testimony
Col [C]: Col. [A] + Col. [B]

OPERATING INCOME ADJUSTMENT # 4 - DEPRECIATION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Depreciation and Amortization	\$ 227,855	\$ 17,249	\$ 245,104

Line No.	ACCT NO.	DESCRIPTION	[A] Company Proposed PLANT IN SERVICE BALANCE	[B] STAFF DEPR. PLANT BALANCE	[C] STAFF RECOMMENDED RATE	[D] STAFF RECOMMENDED EXPENSE
Plant In Service						
2	301	Organization Cost	\$ 127,103	127,103	0.00%	\$ -
3	302	Franchise Cost	-	-	0.00%	-
4	303	Land and Land Rights	494,159	21,638	0.00%	-
5	304	Structures and Improvements	182,570	368,799	3.33%	12,281
6	305	Collecting and Impounding Res.	-	-	2.50%	-
7	306	Lake River and other Intakes	-	-	2.50%	-
8	307	Wells and Springs	386,591	386,591	3.33%	12,873
9	308	Infiltration Galleries and Tunnels	-	-	6.67%	-
10	309	Supply Mains	-	-	2.00%	-
11	310	Power Generation Equipment	-	-	5.00%	-
12	311	Electrical Pumping Equipment	968,652	968,652	12.50%	121,082
13	320.0	Water Treatment Equipment	15,947	-		-
14	320.1	Water Treatment Plant	-	-	3.33%	-
15	320.2	Chemical Solution Feeders	-	15,947	20.00%	3,189
16	330	Distribution Reservoirs & Standpipe	836,890	-		-
17	330	Storage Tanks	-	312,477	2.22%	6,937
18	330	Pressure Tanks	-	452,063	5.00%	22,603
19	331	Transmission and Distribution Mains	1,611,320	1,482,720	2.00%	29,654
20	333	Services	386,947	386,947	3.33%	12,885
21	334	Meters	94,263	94,263	8.33%	7,852
22	335	Hydrants	161,737	161,737	2.00%	3,235
23	336	Backflow Prevention Devices	-	-	6.67%	-
24	339	Other Plant & Miscellaneous Equipment	187,582	187,582	6.67%	12,512
25	340	Office Furniture & Fixtures	-	-	6.67%	-
26	340	Computers & Software	-	-	20.00%	-
27	341	Transportation Equipment	-	-	20.00%	-
28	342	Stores Equipment	-	-	4.00%	-
29	343	Tools and Work Equipment	-	-	5.00%	-
30	344	Laboratory Equipment	-	-	10.00%	-
31	345	Power Operated Equipment	-	-	5.00%	-
32	346	Communications Equipment	-	-	10.00%	-
33	347	Miscellaneous Equipment	-	-	10.00%	-
34	348	Other Tangible Plant	-	-	3.33%	-
35	-	Rounding Amount	-	-	67.00%	-
36		Subtotal General	\$ 5,453,761	\$ 4,966,519		\$ 245,104
37		Less: Non- depreciable Account(s)	621,262	148,741		
38		Depreciable Plant (L29-L30)	\$ 4,832,499	\$ 4,817,778		
39		Contributions-in-Aid-of-Construction (CIAC)			\$ -	
40		Weighted Average Depreciation/Amortization Rate			5.0875%	
41		Less: Amortization of CIAC (L32 x L33)				\$ -
42		Depreciation Expense - STAFF [Col. (C), L36 - L41]				\$ 245,104

OPERATING INCOME ADJUSTMENT # 5 - PROPERTY TAXES

LINE NO.	Property Tax Calculation	[A]	[B]
		STAFF AS ADJUSTED	STAFF RECOMMENDED
1	Staff Adjusted Test Year Revenues - 2009	\$ 594,459	\$ 594,459
2	Weight Factor	2	2
3	Subtotal (Line 1 * Line 2)	\$ 1,188,918	\$ 1,188,918
4a	Staff Adjusted Test Year Revenues - 2006	594,459	
4b	Staff Recommended Revenue, Per Schedule GLF-1		732,459
5	Subtotal (Line 4 + Line 5)	\$ 1,783,377	\$ 1,921,377
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	\$ 594,459	\$ 640,459
8	Department of Revenue Multiplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	\$ 1,188,918	\$ 1,280,918
10	Plus: 10% of CWIP -		-
11	Less: Net Book Value of Licensed Vehicles		-
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$ 1,188,918	\$ 1,280,918
13	Assessment Ratio	20.0%	20.0%
14	Assessment Value (Line 12 * Line 13)	237,784	\$ 256,184
15	Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16)	7.4558%	7.4558%
16	Property Tax Expense - Excludes Parcels (Line 14 * Line 15)	\$ 17,729	\$ 19,101
17	Tax of Parcels	\$ 1,320	\$ 1,320
18	Staff Recommended Test Year Property Tax (Line 16 + Line 17)	\$ 19,049	
19	Company Proposed Property Tax	21,299	
20	Staff Test Year Adjustment (Line 18-Line 19)	\$ (2,250)	
21	Property Tax - Staff Recommended Revenue (Line 16 + Line 17)		\$ 20,421
22	Staff Test Year Adjusted Property Tax Expense (Line 18)		\$ 19,049
23	Increase/(Decrease) to Property Tax Expense Line 21 - Line 22)		\$ 1,372
24	Increase to Property Tax Expense		\$ 1,372
25	Increase in Revenue Requirement		138,000
26	Increase to Property Tax per Dollar Increase in Revenue (Line 24/Line 25)		0.994107%

References:

Col [A]: Company Schedule C-1 Page 3
Col [B]: GLF Testimony

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-18
Phase 3

OPERATING INCOME ADJUSTMENT # 6 - INCOME TAXES

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Income Tax	\$ 22,873	\$ (12,813)	\$ 10,060

References:

Col [A]: Company Schedule C-1 Page 3

Col [B]: Column [C] - Column [A]

Col [C]: Schedule GLF-2

GOODMAN WATER COMPANY
Docket No. W-02500A-10-0382
Test Year ended December 31, 2009

Schedule GLF-18.1
Phase 3

OPERATING INCOME ADJUSTMENT # 7 - ANNUALIZE PURCHASED POWER

LINE NO.	Account Number	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1		Purchased Power	<u>\$ 27,066</u>	<u>\$ 577</u>	<u>\$ 27,643</u>

References:

Col [A]: Company Schedule B-1

Col [B]: GLF Testimony

Col [C]: Col. [A] + Col. [B]

RATE DESIGN

Monthly Usage Charge (all classes)	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" Meter - All Classes	\$ 42.20	\$ 56.97	\$ 47.00
3/4" Meter - All Classes	\$ 63.30	\$ 85.46	\$ 71.00
1" Meter - All Classes	\$ 105.50	\$ 142.43	\$ 118.00
1½" Meter - All Classes	\$ 211.50	\$ 284.85	\$ 235.00
2" Meter - All Classes	\$ 339.68	\$ 455.76	\$ 376.00
3" Meter - All Classes	\$ 675.20	\$ 911.52	\$ 752.00
4" Meter - All Classes	\$ 1,055.00	\$ 1,424.25	\$ 1,175.00
6" Meter - All Classes	\$ 2,110.00	\$ 2,848.50	\$ 2,350.00
Construction/Stand pipe	N/A	N/A	N/A
Commodity Rates (all classes)			
5/8" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.70
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 9,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
3/4" Meter			
From 1 to 3,000 Gallons	\$ 3.95	\$ 6.80	\$ 4.70
From 3,001 to 9,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 10,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
1" Meter			
From 1 to 22,500 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 22,500 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
1½" Meter			
From 1 to 34,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 34,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
2" Meter			
From 1 to 45,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 45,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
3" Meter			
From 1 to 68,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 68,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
4" Meter			
From 1 to 90,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 90,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
6" Meter (Res., Comm.)			
From 1 to 135,000 Gallons	\$ 5.91	\$ 10.92	\$ 9.50
Over 135,000 Gallons	\$ 7.11	\$ 13.13	\$ 11.50
Construction/Stand pipe (Res., Comm.)			
All Gallons	\$ 7.11	\$ 13.13	\$ 11.50

Service Line and Meter Installation Charges	Present	Co. Proposed			Staff Recommended		
	Total	Line	Meter	Total	Line	Meter	Total
5/8" Meter	\$ 225	\$ 385	\$ 135	\$ 520	\$ 385	\$ 135	\$ 520
3/4" Meter	270	415	205	620	415	205	620
1" Meter	300	465	265	730	465	265	730
1½" Meter	425	520	475	995	520	475	995
2" Turbine Meter	550	800	995	1,795	800	995	1,795
2" Compound Meter	550	800	1,840	2,640	800	1,840	2,640
3" Turbine Meter	750	1,015	1,620	2,635	1,015	1,620	2,635
3" Compound Meter	750	1,135	2,495	3,630	1,135	2,495	3,630
4" Turbine Meter	1,375	1,430	2,570	4,000	1,430	2,570	4,000
4" Compound Meter	1,375	1,610	3,545	5,155	1,610	3,545	5,155
6" Turbine Meter	2,800	2,150	4,925	7,075	2,150	4,925	7,075
6" Compound Meter	2,800	2,270	6,820	9,090	2,270	6,820	9,090
8"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
10"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
12"	Cost	Cost	Cost	Cost	Cost	Cost	Cost
Service Charges							
Establishment	\$ 50.00			\$ 50.00			\$ 50.00
Establishment (After Hours)	75.00			75.00			NT
Reconnection (delinquent)	75.00			75.00			75.00
Reconnection (after hours)	50.00			50.00			NT
Meter Test	20.00			20.00			20.00
Deposit Requirement (Residential)	(a)			(a)			(a)
Deposit Requirement (None Residential Meter)	(a)			(a)			(a)
Deposit Interest	6.00%			6.00%			6.00%
Re-Establishment (With-in 12 Months)	(b)			(b)			(b)
NSF Check	15.00			15.00			15.00
Deferred Payment, Per Month	1.5%			1.50%			1.50%
Meter Re-Read	20.00			20.00			20.00
Late Charge per month	1.5%			1.5%			1.5%
Customer Requested Meter Test	20.00			20.00			20.00
After Hours Service Charge	10.00			10.00			50.00
Turn-on/off (at customer request)	NT			75.00			NT
Moving Customer Meter (at customer request)	NT			cost			cost
NT = No Tariff							
Monthly Service Charge for Fire Sprinkler							
All Meter Sizes							Greater of \$10 or 2 percent of the general service rate for a similar size meter.

Per Commission Rules (R14-2-403.B)

- (a) Residential - two times the average bill. Non-residential - two and one-half times the average bill.
(b) Minimum charge times number of months disconnected.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission Rule (14-2-409.D.5).
All advances and/or contributions are to include labor, materials, overheads and all applicable taxes,
Cost to include labor, materials and parts, overheads and all applicable taxes.

Typical Bill Analysis
Residential 5/8 Inch Meter

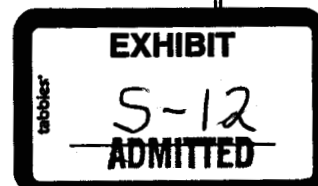
Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	5,477	\$ 66.73	\$ 100.30	\$ 33.57	50.31%
Median Usage	4,500	60.96	89.63	\$ 28.68	47.04%
Staff Recommended					
Average Usage	5,477	\$ 66.73	\$ 84.63	\$ 17.90	26.83%
Median Usage	4,500	60.96	75.35	\$ 14.40	23.62%

Present & Proposed Rates (Without Taxes)
Residential 5/8 Inch Meter

Consumption	Rates	Rates	Increase	Rates	Increase
-	\$ 42.20	\$ 56.97	35.00%	\$ 47.00	11.37%
1,000	46.15	63.77	38.18%	51.70	12.03%
2,000	50.10	70.57	40.86%	56.40	12.57%
3,000	54.05	77.37	43.15%	61.10	13.04%
4,000	58.00	84.17	45.12%	70.60	21.72%
4,500	60.96	89.63	47.04%	75.35	23.62%
5,000	63.91	95.09	48.79%	80.10	25.33%
5,477	66.73	100.30	50.31%	84.63	26.83%
6,000	69.82	106.01	51.83%	89.60	28.33%
7,000	75.73	116.93	54.40%	99.10	30.86%
8,000	81.64	127.85	56.60%	108.60	33.02%
9,000	87.55	138.77	58.50%	118.10	34.89%
10,000	94.66	151.90	60.47%	129.60	36.91%
11,000	101.77	165.03	62.16%	141.10	38.65%
12,000	108.88	178.16	63.63%	152.60	40.15%
13,000	115.99	191.29	64.92%	164.10	41.48%
14,000	123.10	204.42	66.06%	175.60	42.65%
15,000	130.21	217.55	67.08%	187.10	43.69%
16,000	137.32	230.68	67.99%	198.60	44.63%
17,000	144.43	243.81	68.81%	210.10	45.47%
18,000	151.54	256.94	69.55%	221.60	46.23%
19,000	158.65	270.07	70.23%	233.10	46.93%
20,000	165.76	283.20	70.85%	244.60	47.56%
25,000	201.31	348.85	73.29%	302.10	50.07%
30,000	236.86	414.50	75.00%	359.60	51.82%
35,000	272.41	480.15	76.26%	417.10	53.11%
40,000	307.96	545.80	77.23%	474.60	54.11%
45,000	343.51	611.45	78.00%	532.10	54.90%
50,000	379.06	677.10	78.63%	589.60	55.54%
75,000	556.81	1,005.35	80.56%	877.10	57.52%
100,000	734.56	1,333.60	81.55%	1,164.60	58.54%

UNIFORM SYSTEM OF ACCOUNTS FOR CLASS A WATER UTILITIES

1996



NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

1201 Constitution Avenue, N.W., Suite 1102

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Washington, DC 20044-0684

Telephone No. (202) 898-2200

Facsimile No. (202) 898-2213

Price: \$25.00

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ACCOUNTING INSTRUCTIONS

4. General - Accounting Period

Each utility shall keep its books on a monthly basis so that for each month all transactions applicable thereto, as nearly as may be ascertained, shall be entered in the books of the utility. Amounts applicable or assignable to specific utility departments shall be segregated monthly. Each utility shall close its books at the end of each calendar year unless otherwise authorized by the Commission.

5. General - Submittal of Questions

To maintain uniformity of accounting, utilities shall submit questions of doubtful interpretation to the Commission for consideration and decision.

6. General - "Item" Lists

List of "items" appearing in the texts of the accounts or elsewhere herein are for the purpose of more clearly indicating the application of the prescribed accounting. The lists are intended to be representative, but not exhaustive. The appearance of an item in a list warrants the inclusion of the item in the account mentioned only when the text of the account also indicates inclusion inasmuch as the same item frequently appears in more than one list. The proper entry in each instance must be determined by the texts of the accounts.

7. General - Extraordinary Items

It is the intent that net income shall reflect all items of profit and loss during the period with the sole exception of prior period adjustments as described in Accounting Instruction 8. Those items related to the effects of events and transactions which have occurred during the period and which are not typical or customary business activities of the company shall be considered extraordinary items. Commission approval must be obtained to treat an item as extraordinary. Such request must be accompanied by complete detailed information (See accounts 433 and 434).

8. General - Prior Period Items

A. All prior period adjustments to retained earnings shall be approved by the Commission. Generally the only type of transactions which will be considered as a prior period adjustment are:

ACCOUNTING INSTRUCTIONS

(1) Correction of an error in the financial statements of a prior period; or

(2) Adjustments that result from realization of income tax benefits of preacquisition loss carry forwards of purchased subsidiaries.

B. Prior period adjustments, when approved, shall be charged or credited to account 439 - Adjustments to Retained Earnings, and are not considered in income of the period. Prior period adjustments shall be recorded net of all state and federal income tax effects.

C. Changes in depreciation or amortization estimates or methods are considered changes in accounting estimates rather than accounting errors; and therefore are not subject to prior period adjustments. Any adjustments made to the accumulated amortization or depreciation balances of the utility due to a change in estimate or method shall be offset by a charge or credit to either: an income account; account 186.2 - Other Deferred Debits; or account 253 - Other Deferred Credits, as directed by the Commission.

9. General - Unaudited Items

Whenever a financial statement is required by the Commission, if it is known that a transaction has occurred which affects the accounts but the amount involved in the transaction and its effect upon the accounts cannot be determined with absolute accuracy, then the amount shall be estimated and such estimated amount included in the proper accounts. A complete description of the transactions shall accompany the financial statement. Utilities are not required to anticipate minor items which would not appreciably affect the accounts.

10. General - Allocation of Salaries and Expenses of Employees

Charges to utility plant or to a salaries expense account shall be based upon the actual time engaged in either plant construction or providing operation services. In the event actual time spent in the various activities is not available or practicable, salaries should be allocated upon the basis of a study of the time engaged during a representative period. Charges should not be made to the accounts based upon estimates or in an arbitrary fashion.

11. General - Payroll Distribution

Underlying accounting data shall be maintained so that the distribution of the costs of labor charged to the various accounts will be available. The utility may utilize clearing accounts in its accounting process; however, the use of clearing accounts does

BALANCE SHEET ACCOUNTS

- 186.1 Deferred Rate Case Expense
- 186.2 Other Deferred Debits
- 186.3 Regulatory Assets

186.1 Deferred Rate Case Expense

This account shall include all deferred debits associated with the cost of conducting rate cases before the commission.

186.2 Other Deferred Debits

This account shall include all deferred debits not properly includable in any other subaccount of account 186.

186.3 Regulatory Assets

A. This account shall include the amounts of regulatory-created assets, not included in other accounts, resulting from the ratemaking actions of regulatory agencies. (See Definition 27.)

B. The amounts included in this account are to be established by those charges which would have been included in net income determination in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing the rates that the utility is authorized to charge for its utility services. When specific identification of the particular source of a regulatory asset cannot be made, such as in plant phase-ins, rate moderation plans or rate levelization plans, Account 407.5 - Amortization of Regulatory Liabilities shall be credited. The amounts recorded in this account are generally to be charged, concurrently with the recording of the amount in rates, to the same account that would have been charged if included in income when incurred, except all regulatory assets established through the use of Account 407.5 shall be charged to Account 407.4 - Amortization of Regulatory Assets, concurrent with the recovery of the amounts in rates.

C. If rate recovery of all or part of an amount included in this account is disallowed, the disallowed amount shall be charged to Account 426 - Miscellaneous Nonutility Expenses, or Account 434 - Extraordinary Deductions, in the year of the disallowance.

187. Research and Development Expenditures

A. This account shall include the cost of all expenditures coming within the meaning of Definition 29 of the Uniform System of

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WATER UTILITY PLANT ACCOUNTS

10. Special assessments levied by public authorities for public improvements on the basis of benefits for new roads, new bridges, new sewers, new curbing, new pavements, and other public improvements, but not taxes levied to provide for the maintenance of such improvements.
11. Surveys in connection with the acquisition, but not amounts paid for topographical surveys and maps where such costs are attributable to structures or plant equipment erected or to be erected or installed on such land.
12. Taxes assumed, accrued to date of transfer of title.
13. Title, examining, clearing, insuring and registering in connection with the acquisition and defending against claims relating to the period prior to the acquisition.
14. Appraisals prior to closing title.
15. Cost of dealing with distributees or legatees residing outside of the state or county, such as recording power of attorney, recording will or exemplification of will, recording satisfaction of state tax.
16. Filing satisfaction of mortgage.
17. Documentary stamps.
18. Photographs of property at acquisition.
19. Fees and expenses incurred in the acquisition of water rights, and grants.
20. Cost of fill to extend bulkhead line over land under water, where riparian rights are held, which is not occasioned by the erection of a structure.
21. Sidewalks and curbs constructed by the utility on public property.
22. Labor and expenses in connection with securing rights of way, where performed by company employees and company agents.

304. Structures and Improvements

This account shall include cost in place of structures and improvements used in connection with source of supply, pumping, water treatment, transmission and distribution and general plant (See Accounting Instruction 25). A sample of items to be included in this account are listed below:

1. Architects' plans and specifications including supervision.

WATER UTILITY PLANT ACCOUNTS

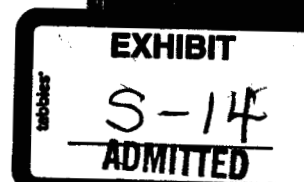
2. Boilers, furnaces, piping, wiring, fixtures and machinery for heating, lighting, signaling, ventilating and air conditioning systems, plumbing, vacuum cleaning systems, incinerator and smoke pipe, flues, etc.
3. Bulkheads, including dredging, riprap fill, piling, decking, concrete, fenders, etc., when exposed and subject to maintenance and replacement.
4. Commissions and fees to brokers, agents, architects and others.
5. Conduit (not to be removed) with its contents.
6. Damages to abutting property during construction.
7. Drainage systems.
8. Elevators, cranes, hoists, etc., and the machinery for operating them.
9. Excavation, including shoring, bracing, bridging, refill and disposal of excess excavated material, cofferdams around foundations, pumping water from cofferdam during construction, test borings.
10. Fences and fence curbs (not including protective fences isolating items of equipment, which should be charged to the appropriate equipment account).
11. Fire protection systems when forming a part of a structure.
12. Flagpole.
13. Floor covering (permanently attached).
14. Foundations and piers for machinery, constructed as a permanent part of a building or other item listed herein.
15. Grading and clearing when directly occasioned by the building of a structure.
16. Intrasite communication system, poles, pole fixtures, wires and cables.
17. Landscaping, lawns, shrubbery, etc.
18. Leases, voiding upon purchase, to secure possession of structures.
19. Leased property, expenditures on.
20. Lighting fixtures and outside lighting systems.
21. Marquee, permanently attached to building.
22. Painting, first cost.
23. Permanent paving, concrete, brick, flagstone, asphalt, etc., within the property lines.
24. Partitions, including movable.
25. Permits and privileges.
26. Water and wastewater systems, for general use.
27. Power boards for services to a building.
28. Retaining walls except when identified with land.
29. Roadways.
30. Roofs.

The Regulation of Public Utilities Theory and Practice

CHARLES F. PHILLIPS, JR.

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Professor of Economics
Washington and Lee University

1988
PUBLIC UTILITIES REPORTS, INC.
Arlington, Virginia



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Depreciation and Depletion

The right of a public utility to a depreciation cost allowance was stated by the Supreme Court in 1909. In the *Knoxville Water Company* decision, the Court recognized that a plant "begins to depreciate in value from the moment of its use," and added:

Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs but for making good the depreciation and replacing the parts of the property when they come to the end of their life. The company is not bound to see its property gradually waste, without making provision out of earnings for its replacement.⁹

In later cases, the Court also approved depreciation provisions for the effects of obsolescence and inadequacy.¹⁰

Public utilities are expected to account fully for the depreciation of their plants. In the Court's words:

It is not only the right of the company to make such a provision, but it is its duty to its bond and stockholders, and, in the case of a public service corporation at least, its plain duty to the public. . . . If, however, a company fails to perform this plain duty and to exact sufficient returns to keep the investment unimpaired . . . the fault is its own.¹¹

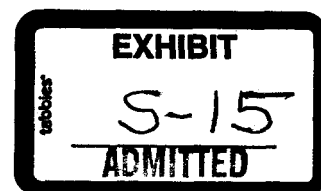
If, therefore, public utilities fail to make adequate charges to cover depreciation costs and do not accumulate the necessary depreciation reserves, they cannot increase their charges at a later time in order to recover the deficiencies from consumers. The key phrase is "adequate charges" and has been the subject of considerable dispute between the companies and the commissions.

In 1934, the Supreme Court held that an allowance for the depletion of irreplaceable natural resources was required.

To withhold from a public utility the privilege of including a depletion allowance among its operating expenses, while confining it to a return of 6-1/2 percent upon the value of its wasting assets, is to take its property away from it without due process of law, at least where the waste is inevitable and rapid. . . . Plainly the state must either surrender the power to limit the return or else concede to the business a compensating privilege to preserve its capital intact.¹²

Taxes

The Supreme Court decided in the *Galveston* case of 1922 that taxes,



PUR GUIDE
Accounting

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Depreciation— Concepts and Practices

In previous chapters we have examined the major items that are included in the revenue requirements equation, including operating expenses, taxes, and valuation of rate base. In this chapter we will look closer at one final factor—depreciation. As noted earlier, depreciation refers to the wearing out of utility plant and equipment. The allowance for depreciation represents one of the most important aspects of public utility regulation. Depreciation practices directly affect cost of service, rate base, and the monthly rates charged to utility customers. Depreciation allowances also play a major role in financial reporting, accounting, and income tax calculation. This chapter begins with a discussion of the nature of depreciation, continues with an explanation of depreciation methods, and concludes with a discussion of calculation of depreciation for tax purposes.

The Nature of Depreciation

If nothing else, depreciation is simply a recognition that all property used in a trade or business wears out and eventually must be replaced. In theory, this deterioration begins from the very first minute a brand-new piece of property is put into use, and continues until it becomes useless. This process of wearing out or losing service value is called depreciation. There are several causes of depreciation, which may be divided into two classes.

First, there is physical depreciation. This includes wear and tear incidental to use caused by friction, vibration, pressure, etc. It also includes such natural causes as rust, rot, or decay, which occur with the passage of time.

The second class of depreciation is not physical, but has to do with other factors which render property less and less useful. This is called functional depreciation. It includes obsolescence, a term that refers to property that has become outmoded by new techniques or improved models that may render old-fashioned equipment too wasteful to operate any longer. Functional depreciation also may include inadequacy—meaning that the growth of service volume or demand has increased so far ahead of the capacity of the property that it must be replaced in whole or in part. Finally, the usefulness of property may be destroyed, so that it has to be retired from service, because of some government requirement, such as increased environmental safety standards or property condemnation by a city, or police or fire regulation, or natural disaster. This could occur years before the property otherwise would wear out.

c Depreciation Concepts

To gain an understanding of depreciation practices and techniques, the reader must become familiar with five basic concepts: basis, salvage value, useful life, depreciation expense, and depreciation reserve.

The term **basis** denotes the original dollar amount of the value of property used in a trade or business. Basis is the starting figure that is used to measure the extent of value that is susceptible to physical wear and tear, and functional obsolescence. The general rule is that the basis of a purchased asset is equal to its original cost (purchase price).

Salvage value refers to the estimated dollar amount that would be received upon a sale of property used in a trade or business after the property has become worn out or unproductive. This amount is sometimes described as gross salvage, as distinguished from net salvage, which is equal to salvage value minus the cost of removing, dismantling, or demolishing the unproductive asset. Gross salvage may be equal to zero or some positive dollar amount; net salvage may be a negative number. Salvage value may or may not be subtracted from basis before computing depreciation. Statement No. 143 and a proposed accounting pronouncement on Property, Plant & Equipment provide accounting and financial reporting guidance for legal obligations to remove property assets upon retirement and the cost of removal.

Useful life refers to the period of time over which property is depreciated. It is often said that useful life is a measure of the length of time that property or equipment is expected to last before being replaced, but there is no requirement for the retirement and replacement of property once its useful life has expired. Also, it is permissible to repair or remove property from service before the end of its useful life. The point is that useful life is an estimate of the period of time during which a business should recognize the ongoing loss of value of its assets.

The term **depreciation expense** describes the annual allowance for depreciation of property or equipment. The use of the term "expense" does not mean that a business actually must tender cash out of pocket to claim a depreciation allowance; it only represents that portion of value of property that has been "used up" (on paper, at least) during the past 12 months. Since basis represents the total value of property subject to depreciation, it follows that basis must be reduced (adjusted) by the amount of each annual depreciation expense.

Depreciation reserve is the account that represents the accumulation of the various yearly allowances for depreciation expense. The reserve is a valuation or contra asset that reflects the using up of plant and equipment. The reserve is also a notation of the funds received from customers for the use of plant and facilities. The depreciation reserve is sometimes called accumulated or accrued depreciation, and reduces plant investment in the rate-making process. Just as each annual depreciation expense allowance is subtracted from income, each annual allowance is added to the reserve.

Utility Rate-making Issues

Depreciation affects utility rates in two fundamental ways. First, the annual depreciation allowed for property dedicated to public utility service is a component of a utility's operating expenses. The expense for depreciation is recovered directly from customers in the rates they pay for electric, natural gas, water, or telephone service, provided that the depreciation allowance is deemed reasonable by the public utility commission. Second, the accrued depreciation reserve is subtracted from rate base, meaning that the utility is not entitled to earn a rate of return (a profit for its bondholders and stockholders) on the amount of its asset investment already recovered from customers.

It is easy to see why the annual depreciation expense is included in rates. When a utility purchases an asset, such as the turbine that operates inside a steam-powered electric generating plant, the purchase price (excluding interest charges and taxes) does not immediately represent an expense. At the date of the purchase, the utility has not really given up value, it only has exchanged one asset (cash) for another (the turbine). It is only when the turbine is used to produce electricity that the utility truly suffers a loss of value for which it must receive compensation. That lost value is a cost of producing electricity, just as is the cost of the coal or oil (or uranium) that fires the boiler that produces the steam that turns the turbine. Therefore, depreciation is an operating expense.

It may be more difficult to discern why accrued depreciation should be deducted from the rate base. One reason is that every dollar of depreciation reserve was once a dollar of depreciation expense that was included in operating expenses and collected from ratepayers. If the depreciation reserve were not deducted from the rate base, the utility would earn a return on the portion of assets already paid for by customers.

If a utility changes (or is ordered to change) its annual depreciation rates (by revising its estimates of useful life, for instance), it also must adjust the rates it collects from its customers. But what about depreciation reserve and rate base?

Suppose that a utility requests a rate increase in 2004 and proposes at the same time to increase the annual depreciation rate for a nuclear power plant. The utility's vice president explains in testimony given to the state commission that after reading the latest data on nuclear plant reliability, the utility's engineers discovered that the depreciation rate should have been at the higher level since the plant began operating.

Consider what this means. If the higher rate had been in effect during those early years of operation, the utility now would possess a larger reserve and a correspondingly smaller rate base. With a smaller rate base, its revenues would fall proportionately. Knowing these facts, the state consumer advocate tries to convince the public utility commission to increase reserve and decrease rate base by the hypothetical amount of depreciation that would have been allowed. The consumer advocate's proposal will cut back rate base by several million dollars. The utility's vice president objects, arguing that it is unfair to make rate-making decisions by speculating about what might have happened years ago. Who wins?

Depreciation— Concepts and Practices

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Mr. James Shiner
Goodman Water Company
6340 North Campbell Avenue, Suite 278
Tucson, Arizona 85718

AZ CORP COMMISSION
DOCKET CONTROL

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RE: COMPLIANCE ITEM FROM GOODMAN WATER COMPANY, DOCKET NO. W-02500A-06-0281, DECISION NO. 69404, DATED APRIL 16, 2007

Dear Mr. Shiner:

Your rate review application was received on March 25, 2010. This filing was made pursuant to Decision No. 69404 dated April 16, 2007, requiring Goodman Water Company ("Company") to file a rate review three years from the effective date of that Decision. This is to inform you that your rate review filing fulfills that compliance requirement of Decision No. 69404.

Staff's review of the unaudited financial information provided by you indicates that:

1. The Company is earning a 2.28 percent rate of return on its estimated rate base.
2. The Company appears to have an unauthorized long-term loan in excess of \$500,000.

Staff recommends that the Company file a rate increase application as soon as may be practicable. Staff further recommends that the Company file a financing application for any long-term debt it maintains.

Staff will proceed to file a notice of non-compliance if a financing application request covering your unauthorized debt is not received within 45 days of the date of this letter. (Form is available on our website at <http://www.azcc.gov/divisions/utilities/forms/financeApp.pdf>.)

If you have any questions, please contact Brendan Aladi at (602) 542-0785, or toll free at (800) 222-7000.

Sincerely,

Nancy L. Scott

Nancy L. Scott
Chief, Financial & Regulatory Analysis Section
Utilities Division

cc: 13 copies